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No. 20074

IN THE

United States Court of Appeals For the Ninth Circuit

K-91, Inc.,
Appellant,
v.
Gershwin Publishing Corporation, et al.,
Appellees.

Appeal from the United States District Court for
The Western District of Washington,
Northern Division

Honorable Gus J. Solomon, *Chief Judge*

BRIEF OF APPELLANT

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BRIEF OF APPELLANT

STATEMENT DISCLOSING JURISDICTION

The United States District Court for the Western District of Washington, Northern Division, the trial court, had jurisdiction of this cause by virtue of the Judiciary and Judicial Procedure Act, 28 U.S.C.A. §§ 1337 and 1338.

The complaint of appellees (R. 1) discloses that appellees were the owners of copyrights to musical compositions alleged to have been infringed by appellant and that the appellees sued the appellant under the Copyright Act, 17 U.S.C.A. §§ 1 and 101, for infringement seeking damages and injunctions.

The appellant answered (R. 4) alleging the appellees were misusing their copyrights, including the copyrights

in question in violation of public policy and Sections 1 and 2 of the Sherman Act, U.S.C. §§ 1 and 2, and, therefore come into court with unclean hands, and were barred from receiving relief. Appellant also counterclaimed (R. 4) for damages and injunctive relief pursuant to the Federal Rules of Civil Procedure, Rule 13(a), 28 U.S.C.A., Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2, and Sections 4 and 16 of the Clayton Act, 15 U.S.C. §§ 15 and 26.

This appeal is from a final judgment rendered in the United States District Court for the Western District, Northern Division, against appellant (R. 11). This court has jurisdiction to review such judgment by virtue of the Judiciary and Judicial Procedure Act, 28 U.S.C.A. § 1291.

STATEMENT OF THE CASE

The Nature of the Action

APPELLEES, owners of copyrights to certain musical compositions, filed actions against three radio broadcasting stations and an individual officer and stockholder of one of them, claiming violations of the federal copyright law. Appellees seek damages for infringement and injunctions restraining future infringement of their copyrighted works, as well as attorney fees and costs.[1]

The appellants admitted that the musical compositions named in appellee's complaints were performed on its

1. In a period of eighteen months appellees and other members of ASCAP brought 15 separate suits against 11 radio stations in Washington, alleging 272 separate copyright infringements (R. 30, Fact 40, p. 8). The minimum statutory damages demanded was $68,000 and the maximum demanded was $1,360,000, plus attorneys fees and costs. Several of these suits were settled before trial, several settled after trial, and the present one was appealed.

radio station without first obtaining a license to perform them, but it contended that the copyright owners were misusing their copyrights in violation of public policy and state and federal laws and are themselves barred from maintaining their actions and entitled to no relief. Specifically the appellant claimed appellees illegally extended their copyrights, appellees' method of doing business was in violation of the Sherman Antitrust Act (15 U.S.C.A. §§ 1-7), and appellees violated the Constitution and the laws of the State of Washington, Chapter 218, 1937 Session Laws (RCW, Chapter 19.24). Appellant contended that by reason of "unclean hands" the copyright owners have neither legal nor equitable standing to maintain their actions.

The alleged improper use of the copyrights and violations of the antitrust laws were also the basis of a counterclaim filed by the appellant wherein the appellant sought treble damages and orders enjoining the copyright owners from further misuse of their copyrights, pursuant to Rule 13(a) of the Federal Rules of Civil Procedure and Sections 4 and 16 of the Clayton Act (15 U.S.C. §§ 15, 26).

The district court found that the copyright owners had not unlawfully extended their copyrights or violated either the federal antitrust laws or the laws of Washington State, and that their actions were not barred by reason of "unclean hands." As the appellant did not contest the infringements of the musical copyrights, the district court granted the appellees injunctions, damages and counsel fees.

Subsequent to the lower court's decision, the actions involving two of the corporate radio station defendants

and the individual defendant were settled and satisfactions of judgments were entered (R. 49, Settlement Agreement). The action involving one of the corporate radio stations, K-91, Inc., was not settled and the defendant elected to appeal.

The Appellant

The appellant operates a radio station with the call letters KIXI, located in Seattle, Washington, pursuant to a license granted by the Federal Communications Commission (R. 37, Fact 3, Tr. 15-16).

Seattle is the hub of a major metropolitan area. KIXI is one of 14 radio stations and five commercial television stations competing in the market. There are also scores of movie theatres in the Greater Seattle-Tacoma metropolitan area. In addition there are hundreds of night spots, restaurants, hotels, theatres, symphonies and other establishments which perform music as a part of their public offerings. The appellant and the defendants who chose not to appeal broadcast only a special style of programming which requires a pre-selected kind of music. This music style is described or characterized in broadcasting circles as "good music" programming or playing "standards" (Tr. 8-11). Appellant never broadcasts western, hillbilly, rock and roll or jazz (Tr. 9). It seldom broadcasts religious music, but relies almost exclusively on popular standards and light classical styles. The kind of sound the station tries to project to attract and hold its audience is of extreme importance and the selection of music therefore is critical (Tr. 9, 171, 210). The greatest source of the kind of music appellant needs is controlled by the licensing

agency of which appellees are members (Tr. 165, 205, 273). The appellant must be able to broadcast this music to remain in business (Tr. 165, 205, 246, 273, 314) (R. 37, Fact 18).

The Nature of the Copyrights

The Copyright Act of 1909 defines the various rights granted to copyright owners. Among these are the right of mechanical reproduction or the recording right (e.g. phonograph records) and the right to perform the work publicly for profit (e.g. radio broadcasts). The performance right is the primary right involved herein. It is distinct from the right to print sheet music, or the right to record music on records or on motion picture films. The latter is called in the trade a synchronization right. It will be seen later that both recording and synchronization rights are licensed differently from performance rights.

Broadcasters are not the only ones needing performance rights. Movie theatres need the rights when a sound-recorded film is shown. Night clubs perform music for profit, as do symphonies, theatres, restaurants, hotels, private clubs, dance halls, skating rinks, cocktail lounges, etc. (Tr. 5). All perform music extensively and all must be licensed. Appellees license performance rights to broadcasters on a pooled basis and in bulk. This is accomplished by assignment of the music performing rights to the American Society of Composers, Authors & Publishers (R. 37, Facts 20, 21).

The American Society of Composers, Authors and Publishers

The Nature of ASCAP

ASCAP is a voluntary association which was organized in 1914 for the purpose of licensing the public performance of musical compositions of which the members owned the copyrights. It was felt that a large organization with nationwide coverage could police for infringements, and if any were detected, ASCAP would attempt to get the infringer to take a blanket license covering all of the works of its combined members. If the infringer refused, ASCAP would have a suit filed for infringement. (For background, see *Alden-Rochelle, Inc. v. ASCAP*, 80 F.Supp. 888 (1948) at 891.)

The procedure was then and still is that each member assigned to ASCAP all its non-dramatic performing rights of its copyrighted musical compositions (R. 37, Fact 21, Def. Ex. A-4). The sums ASCAP collected from license fees were and still are kept in a common fund and the proceeds are divided, less expenses, at regular intervals (R. 37, Fact 20, Def. Ex. A-3). The appellees have assigned each of the compositions alleged infringed to ASCAP and these were in turn deposited in the pool. In fact, all the performance rights which are owned by a member of ASCAP must be assigned to ASCAP for mutual licensing (R. 30, Fact 18, p. 5; R. 37, Fact 20, Def. Ex. A-4).

> "The performing rights pool thus licensed by ASCAP encompasses the predominate bulk — estimated at times to be from 85 to 90 per cent — of the popular and classical music of this country and not passed into the public domain. To this must be added the copyrighted music of some 40,000 foreign

composers and authors, whose respective national performing societies have authorized ASCAP to license their compositions for performance in the United States." Timberg, *The Antitrust Aspects of Merchandising Modern Music,* 19 Law and Contemp. Problems, 294, 297 (1954). See also Justice Black, dissenting in *Gibbs v. Buck*, 207 U.S. 66 at 81 (1939); *Buck v. Swanson*, 33 F. Supp. 377, 386 (D. Neb. 1939); *Buck v. Gallagher*, 36 F. Supp. 405 (WD Wash. 1940.)

By the 1930s when radio stations first began to acquire economic significance, ASCAP had virtual control of all copyrighted music published in the United States. *Watson v. Buck*, 313 U.S. 406 (1940); *Alden-Rochelle v. ASCAP*, 80 F.Supp. 888 (SDNY. 1948); *Alden-Rochelle v. ASCAP*, 80 F.Supp. 900 (SDNY. 1948).

Today ASCAP is an association of over 8,800 members comprising both writers and publishers (R. 37, Fact 16; R. 30, Fact 11, p. 3). It controls more than a million musical compositions in its performing rights pool (R. 30, Fact 12, 13). Three music licensing organizations in the United States license the non-dramatic performing rights of substantially all of the copyrighted works in the United States today. ASCAP is one of these three, and more than 50% of all performances of copyrighted music broadcast in the United States are licensed by ASCAP (R. 37, Fact 18).

In 1962 ASCAP collected almost 35 million dollars from license fees. Over 30 million dollars came from broadcasters. Revenue from all other licenses was a little over 4 million dollars (R. 30, Fact 49, p. 9). More than 87% of ASCAP's total revenue is derived from license fees paid by broadcasting stations and networks, and less than 13% from all other users of music combined (R. 30, Fact 48,

p. 9). In the State of Washington 100% of ASCAP's collections are from broadcasters and ASCAP collects nothing from other music users (R. 30, Fact 21, p. 5).

ASCAP is governed by a board of directors of twenty-four members, twelve are selected by the publishers and twelve by the composers and authors (R. 30, Fact 24, p. 6; Def. Ex. A-4). Each twelve determines how to share revenues among its respective side. From this determination there is a right of appeal to a Board of Appeal, and from its decision an appeal may be taken to the full board of directors (Def. Ex. A-4). (See Schmel and Krasilovsky, *The Business of Music,* 94-101 (1964).)

The performance rights to some music in ASCAP's repertory is vastly more valuable than the rights to other music in the ASCAP repertory and of all the millions of musical compositions copyrighted very few become hits or of any significant value. This is also true of the music written by the appellees (R. 30, Fact 83, p. 14). Notwithstanding this, the revenues pooled and distributed by ASCAP to its members from fees are not and cannot be segregated to determine how much money is allocated to any particular composition (R. 30, Fact 84, p. 14). Nor can ASCAP's distributions be allocated to a particular area or state (R. 30, Fact 85, p. 14).

The fee to be quoted for any license is initially determined by the ASCAP board of directors as distinguished from its members. The board of directors also determines the form of the license and the basis upon which a fee is to be charged (R. 24, Fact 24, p. 6).

ASCAP Licenses

ASCAP licenses broadcasting stations under only two types of licenses, one of which is named "Blanket" and the other "Per Program" (R. 30, Fact 22, p. 4; Def. Ex. A-9). Both are bulk licenses or blanket licenses of ASCAP's entire repertory.

> "ASCAP licenses only the pooled aggregate of the performing rights assigned to it by its members, i.e., its entire repertory . . . Its licenses always convey a blanket authorization to the licensee to use its entire repertory; it never licenses the right to perform individual pieces, or individual publisher's catalogues, or any part of its total repertory." Timberg, *Ibid.* at 297.

As ASCAP's chief counsel, Herman Finkelstein, explains:

> "ASCAP is an association of composers, authors, and publishers of musical works banded together for the purpose of licensing the public performance rights of their works on a bulk basis. . . ." Finkelstein, The Composer and the Public Interest, 19 Law and Contemp. Problems 275, 283 (1954).

Both licenses required by ASCAP grant radio stations the right to use all of ASCAP's million or so copyrights on "local radio programs," which are defined to mean programs "other than a network radio program" (Def. Ex. A-9). Under both licenses the station must pay fees based on a percentage of the gross revenues of the station, plus a sustaining fee (R. 30, Fact 23, p. 5; Def. Ex. A-9). No other forms of licenses are offered (R. 30, Fact 25, p. 6).

Under the license described as a "Local Station Blanket License" a fee is charged upon revenues received by the station from all local radio programs, including those which use no ASCAP music whatsoever (Def. Ex. A-9).

Under the type described as "Local Station Per Program License," the station pays to ASCAP a fee based upon revenues received from programs which use ASCAP music. The fees charged for the Blanket License are 2.125% of the gross revenues of the radio station (Def. Ex. A-9). The fees charged for the Per Program License are 8% of the gross (Def. Ex. A-9).

Of the over 5,000 commercial stations licensed by the Federal Communications Commission and broadcasting in the United States today, fewer than 60 to 100 have elected to use the Per Program License. None are using it in Washington State (R. 30, Fact 57, 62, p. 11).

Broadcasting networks are also licensed by ASCAP (Def. Ex. A-10). The networks collect fees from affiliated stations for music on network programs broadcast over the affiliate and pass the fees on to ASCAP (R. 30, Pretrial Order, Admission 1, p. 1). These fees are in turn distributed to ASCAP's members (R. 30, Pretrial Order, Admission 2, p. 1). Therefore, it is not necessary for a station to have a separate license to play music which is supplied from networks because the performance rights are cleared for the affiliated stations at the source (R. 30, Fact 59, p. 11). This type of licensing is sometimes called "clearance at the source."

ASCAP's Washington Licensing Practices

Except for a short period of time in and around 1959, ASCAP has been engaged in issuing performance licenses in the State of Washington (R. 30, Fact 19, p. 5). The licenses are mailed by ASCAP from New York City, signed by the music user in this state, thence returned

for signature by ASCAP in New York (R. 30, Fact 19, p. 5). ASCAP receives license fees from broadcasters in Washington and in turn distributes the fees to its members. Therefore, each of the appellees herein has been paid and received and will continue to be paid and receive royalty compensation and other consideration from broadcasters located in Washington (R. 30, Fact 20, p. 5). Significantly, however, broadcasting stations are the only users of music located in the state from whom ASCAP collects fees (R. 30, Fact 21, p. 5). Furthermore, the appellees collect no fees from any other users located in this state. Other commercial users of music like theatre exhibitors, night clubs, bowling alleys, taverns, restaurants, etc., have not been paying fees in Washington State, but broadcasters have (R. 30, Fact 21, p. 5).

The only licenses offered to broadcasters in Washington State are blanket type licenses (R. 30, Facts 25, 26, 28, 44; Def. Ex. 7-8a, Pl. Ex. 6). Yet ASCAP offers to all other users of music in Washington, except broadcasting stations, licenses where fees are charged for performances of specific compositions, i.e. per piece licenses (R. 30, Facts 25, 26, 43; Def. Exs. 7-8a, Pl. Ex. 6). But as stated above, no fees are collected from these other users.

In 1958, all ASCAP radio licenses expired on the common date of December 31, 1958. Consequently, in 1959 after expiration of the 1958 licenses, ". . . ASCAP refused to offer licenses to any broadcasters located in the State of Washington" (R. 30, Fact 73, p. 13). With this source of music cut off completely, broadcasters in Washington faced the prospect of infringement suits or closing down for lack of music (Tr. 165, 205, 246, 273, 314). This forced stations to negotiate with ASCAP for business. After

several months of negotiating, many stations and ASCAP agreed to a compromise. Accordingly, a petition was filed in the United States District Court for the Southern District of New York asking the court to enter an order (R. 30, Fact 73, p. 13; R. 37, Fact 40). The petition was filed and an order entered on the same day, November 20, 1950. Being a negotiated instrument, the order was entered by stipulation and agreement of the parties (R. 30, Fact 74, p. 13). It directed ASCAP to issue licenses in one of two agreed forms for the period January 1, 1959, through December 31, 1963 (R. 37, Facts 43, 44; Pl. Exs. 11, 12).

Appellant was apprised of the proceedings described above, but did not sign a license on the ground that it was illegal to do so and because the Washington law provided:

> ". . . All licensees of any violator of this chapter shall be deemed as aiders and abettors. RCW 19.24.-100 (Def. Exs. A-13, A-14, A-50).
>
> "Every person . . . who violates or who procures, aids or abets in violating of any provision of this chapter . . . or who procures, conspires with, or aids or abets any person or persons in his or their future to obey the provisions of this chapter . . . shall be deemed guilty of a gross misdemeanor, and upon conviction shall be punished by a fine . . . or imprisonment . . ." RCW 19.24.290.

Furthermore, appellant had been advised by counsel and was of the firm belief that ASCAP and its members constituted a combination in restraint of trade, and ASCAP's members were misusing their copyrights in violation of the federal copyright and antitrust laws (Tr. 202, 205, 206, 251, 252, 299, 301).

Defendants were also convinced that the means of licensing employed by ASCAP and its combined mem-

bers was an abuse of the copyright privilege, unjust, unreasonable and unfair; and that if copyright owners were required to compete among themselves, competitive forces and the market's impersonable judgment would establish a better system of music allocation (Tr. 173, 170-211, 265-266, 268-269, 284, 303-305, 306-307, 317, 318).

ASCAP's Antitrust History

Over twenty years ago, on February 26, 1941, the United States brought an action against ASCAP charging ASCAP and its members with violations of the Sherman Antitrust Act, resulting on March 4, 1941, in a final decree on consent of the parties (Def. Ex. A-1) (*United States v. ASCAP*, Civil Action No. 13-95 (S.D.N.Y.).

The 1941 decree was superseded on March 14, 1950, by the amended final judgment commonly known as the 1950 Consent Decree (Def. Ex. A-2). This amendment resulted from two significant federal court decisions holding that the 1941 decree did not adequately cure ASCAP's unlawful licensing practices.[2]

Shortly after the *Alden-Rochelle* case was decided, Chief

2.

"On July 18, 1948, Federal District Judge Leibell handed down his memorable opinion in the *Alden-Rochelle* case declaring ASCAP to be involved in an illegal monopoly and illegal restraint of trade under Sections 1 and 2 of the Sherman Act . . . ASCAP, said the court, had the power to raise prices and exclude competitors when it desired to do so." (Timberg 299)

With respect to the Section 1 charge, the court stated in part:

"The combination of the members of ASCAP in transferring all their non-dramatic performing rights to ASCAP is a combination in restraint of interstate trade and commerce, which is prohibited by Sec. 1 of the anti-trust laws. It restrains competition among the members of ASCAP in marketing the performing rights to their copyrighted works." *Alden-Rochelle, Inc. v. ASCAP*, 80 F.Supp. at 894 (S.D.N.Y., 1948).

Judge Nordbye of the Federal District Court in Minnesota, in *M. Witmark & Sons v. Jensen*, 80 F. Supp. 843 (1948), endorsed Judge Leibell's conclusion that ASCAP was still a price-fixing combination (Timberg, 300).

The amended final judgment of March 14, 1950, introduced a number of changes pertinent to the issues raised on this appeal (Def. Ex. A-2):

1. Although the 1941 decree limited ASCAP to taking only non-exclusive licenses from its members this limitation was reinforced by Section IV(B) which enjoined ASCAP from "limiting, restricting, or interfering with the right of any member to issue to a user non-exclusive licenses for rights of a public performance."

2. Sections V(A) and (B) revised the provisions of the 1941 decree concerning the issuance of licenses to networks and to manufacturers, to make it clear that they applied to the television industry as well as the radio industry.

3. A new provision, Section V(c), also required ASCAP to issue to motion picture producers a single license covering motion picture performance rights throughout the United States. This kind of licensing along with that required in V(A) and (B) is called in the trade "licensing at the source" or "clearance at the source."

4. A new provision, Section VI, directed ASCAP "to grant to any user making written application therefor a non-exclusive license to perform all the compositions in the ASCAP repertory."

5. A new provision, Section IX, directed that ASCAP shall "upon written application for a license for the right of public performance of any, some or all of the composi-

tions in the ASCAP repertory, advise the applicant in writing of the fee which it deems reasonable for the license requested," and that if the parties are unable to agree upon a reasonable fee within 60 days, the applicant may apply to the district court in New York for the determination of a reasonable fee.

6. Other sections of the amended final judgment enjoined ASCAP from attempting to issue or enforce any performance licenses against motion picture theatre exhibitors and revised certain provisions of the 1941 decree concerning ASCAP's internal affairs and the distribution of fees collected by ASCAP. Some of these latter provisions were further amended on January 7, 1960 (Def. Ex. A-3).

At the present time, because of continuing dissatisfaction among ASCAP's own members, John C. McGeehan by order of the court having jurisdiction of the consent decree is examining the design and conduct of ASCAP's method of surveying performances. Whether this will result in additional amendments to the decree remains to be seen.

ASCAP and State Legislation

In the 1930s, prior to the 1941 consent decree, frustrations of music users and their helplessness when confronted with ASCAP's monopoly power, motivated several state legislatures to take action. The Washington Protection of Copyrights Act, RCW 19.24 was passed in 1937. Several other states passed laws in attempts to protect their citizens.[3]

3. Such statutes were enacted in Vermont (Vermont Rev. Stat. c.54, Sec. 1175 (1947)); Nebraska (Neb. Rev. Stat. Sec. 59-1402 (1943)); North Dakota (N.D. Rev. Code, Sec. 47-2105 (1943)); Kansas (Gen. Stat. Kan. Sec. 57-205 (1940)); Florida (Laws of Fla. Ch. 19653 (1939)); Wisconsin (Wis. State Sec. 17701 (1937)); amend Laws Wis. (1937, c. 247, Laws Wis. and 177 (1941)); Montana Laws of Mont. (1937, c. 90)). See Warner, Radio & Television Rights 275 (1953).

ASCAP lost no time in challenging the legislation. But the United States Supreme Court readily disapproved of ASCAP's charge of federal supremacy and unconstitutionality. In the famous *Buck* case the court upheld a state's power to outlaw activities of price fixing combinations composed of copyright owners. Like the Washington act, both the Florida and Nebraska statutes made it unlawful for copyright owners to combine and operate within the state for the purpose of determining and fixing license fees.[4]

ASCAP also tried to test the constitutionality of the Washington law but the trial court dismissed ASCAP's challenge for lack of jurisdiction. *Buck v. Case,* 24 F. Supp. 541 (1938). On appeal the United States Supreme Court reversed. *Buck v. Gallagher,* 307 U.S. 95, 59 S.Ct. 740, 83 L.ed. 1128 (1939). Again ASCAP sued in the district court alleging unconstitutionality. The question was never answered. The district court held ASCAP could not invoke the aid of equity because its operations were in violation of the Sherman Act and its hands were unclean. *Buck v. Gallagher,* 36 F. Supp. 405 (D. Wash. 1940).[5]

4. The court stated:
"And, unless constitutionally valid federal legislation has granted to individual copyright owners the right to combine the state's power validly to prohibit the proscribed combinations cannot be held non-existent merely because such individuals can preserve their property rights better in combination than they can as individuals. We find nothing in the copyright laws which purports to grant to copyright owners the privilege of combining in violation of otherwise valid state or federal laws . . . We are pointed to nothing either in the language of the copyright laws or in the history of their enactment to indicate any congressional purpose to deprive the states, either in whole or in part, of their long recognized power to regulate combinations in restraint of trade." *Watson v. Buck,* 313 U.S. 387, 403-404 (1941); *Marsh v. Buck,* 313 U.S. 406 (1941).

5. The district court said:
"Plaintiffs contend that the Washington statute is unconstitutional for a number of reasons . . . Before passing on that question, it is

Since *Buck v. Gallagher,* ASCAP has not challenged the Washington law. However, in 1948, ASCAP brought a suit for declaratory judgment to establish it had complied with the law. The Washington Supreme Court found to the contrary. It found ASCAP was claiming copyrights and the right to license songs on which the copyrights had expired and were part of the public domain. *Taylor v. State,* 29 Wn.2d 638 (1948).

The last court decision to be rendered on the Washington statute was by the Yakima County Superior Court in an order entered on July, 1962. This case is one involving a broadcaster licensed to ASCAP. It is still pending, and no doubt what is decided by this court will have bearing upon some of the questions pertaining to Washington statute. (In the Superior Court of the State of Washington, *Cascade Broadcasting Co. v. ASCAP,* No. 45887).

Radio Station Music Requirements

Music is a critical necessity to the broadcaster. Without it he cannot operate (Tr. 5, 6; R. 30, Fact 45, p. 9). A

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necessary to determine whether or not plaintiffs may invoke the aid of a court of equity. If a party has been engaged in an illegal business and been cheated, equity will not help him.' *Wheeler v. Sage,* 68 U.S. 518, 1 Wall. 518, 529. In other words, before plaintiffs may invoke the aid of a court of equity, they must come into court with clean hands. *Keystone Co. v. Excavator Co.,* 290 U.S. 240, 244, 54 S.Ct. 146, 78 L.Ed. 293. If the society exists in violation of the Sherman Anti-Trust Act, 15 U.S.C.A. Secs. 1-7, 15 note, it, and the members composing it, are not entitled to a decree for its benefit.

° ° °

"There can be little question here that the Society has the power to fix prices for the right to publicly perform compositions for profit. Likewise, it has restricted substantially all competition in the sale of such right, because it has all such rights. Since the interstate commerce feature is conceded to be present, the Society clearly violates the act in question . . ." *Id.* at 406, 407.

radio station must have access to copyrighted music as a great portion of its time is devoted to broadcasting music (Tr. 5, 6; R. 30, Facts 45, 47, p. 9).[6]

Because of the importance of music to broadcasters, appellant (and the other defendants who settled) use extreme care in the selection of what music is to be broadcast. Mr. Walter Nelskog, vice president and general manager of appellant's radio station KIXI, reviews every record before it is played in order to be sure the station has and maintains a certain sound or image (Tr. 9).

Modern radio stations need and desire only certain types of music to fit their special kind of programming (Tr. 8). Examples are some play only western music, others religious, others classical (R. 30, Fact 81, p. 14). KIXI does not play rock and roll, western, hillbilly or other types of music (Tr. 9). It broadcasts only standards using special orchestral arrangements (Tr. 10, 11). In fact, all modern radio stations specialize in certain kinds of music played. They have need only for limited catalogues of music, and cannot possibly use the entire ASCAP repertory of over 1,000,000 compositions (Tr. 8, 9, 18, 173, 200, 201). Several of the defense witnesses testified to these facts.

ASCAP does not offer licenses of specialty catalogues to radio stations. Instead ASCAP licenses its entire repertory of popular, western, religious, classical, standards, etc., in one package and radio stations are, therefore, required

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6. Radio stations must compete for the public's attention. They must have an audience in order to sell their time to sponsors (Tr. 6, 7). Broadcasters compete with night clubs, television stations, theatres, restaurants and other industries in the entertainment field for their share of the public's time and attention (Tr. 6). Thus, broadcasters are in competition with many other users of music, including other stations.

to take all of ASCAP's 1,000,000-plus compositions or none (R. 30, Fact 82, p. 14).

The appellant (and the defendants who settled) cannot operate its station and stay in business without using ASCAP music (Tr. 105, 205, 246, 273, 314). Thus, an ASCAP license is vital since more than 50% of all performances of copyrighted music by broadcasting stations in the United States are licensed by ASCAP and are performances of compositions in the ASCAP repertory (R. 30, Fact 48, p. 9).

Not all of the revenues received by radio stations are derived from programs containing music. Stations have many programs such as news, sports, discussion, etc., which contain no music at all (Tr. 17, 140, 224, 226-227, 305). Nevertheless, the only licenses offered by ASCAP require that the station pay over 2% of all its gross revenues to ASCAP, even on programs using no music, or that the station pay 8% of gross revenues on only those programs containing music.[7]

Almost all music played on radio stations today is from records (Tr. 274). These are obtained from recording companies who, along with copyright owners, are most anxious to have stations broadcast their records in order to stimulate record sales (Tr. 24, 168). However, there is no way for a broadcaster to obtain a performance right from a recording company or anyone else when he buys a record (R. 30, Facts 80, 87, 67, 68, 69). The record itself carries no right to play it on a radio station (R. 30, Facts 58, 63, 64). Neither ASCAP or the appellees has ever offered record companies licenses authorizing broadcasting

7. As previously established, out of over 5,000 stations licensed today, less than 100 chose the license charging 8%. (R. 30, Facts 57, 62, p. 11.)

stations to perform the music contained on the record, i.e. cleared the record for performance at the source (R. 30, Facts 63, 64, 65, 66, pp. 11, 12).

Agreements between recording companies and composers (including the appellees by stipulation) provide that the right to record the music does not include the right to play it, and accordingly the performance right is left for only ASCAP to license (Def. Ex. 41, 42, 12).[8]

SPECIFICATION OF ERRORS

Preface

Because on several occasions prior to the trial the trial court asked the parties to stipulate to as many facts as possible, a very detailed and lengthy pretrial order was written (R. 30). The court also asked that all contentions of fact and law be specifically set forth. Accordingly the contentions were detailed and lengthy (R. 30, Pretrial Order and Exhibits).

Following the same procedure after the trial the appellees submitted and the trial court entered detailed Findings of Fact and Conclusions of Law (R. 37). It, therefore, seems to the writer that his duty to the court and to his client requires that he set forth his specifications of error consistent with and in the same detailed form as the trial court required in the Pretrial Order and the Findings of Fact and Conclusions of Law. This requires a large number of individual specifications because each fact and conclusion of law must be asserted and numbered separately.

8. This is so in face of the fact that composers and publishers, including these appellees, as well as recording companies, actively compete to have their music recorded and played on radio stations. (R. 30, Fact 59, p. 11; Def. Ex. A-2.)

Fortunately, most of the specifications of error fall into fairly broad classes. These are that the trial court erred in finding certain facts and conclusions of law, and that it erred in not finding others. Accordingly, for the sake of simplification and orderly classification, the writer has set forth in that portion of the brief immediately following each separate specification of error where the appellant disputes a finding of fact or conclusion of law set forth either in the Findings of Fact and Conclusions of Law (R. 37) and in the trial court's Memorandum Opinion (R. 37). However, each detailed fact or conclusion of law not found by the trial court but stipulated to by the parties or contended by the appellant in the Pretrial Order has been attached to the brief in Appendices "A-E." Each is numbered individually for ease of reference.

Facts

The court erred in finding that:

1. Defendants failed to prove plaintiffs or ASCAP violated Washington law relating to pooling of their interests without providing for per piece licensing (R. 35, Mem. Opin. p. 5).

2. There was no evidence of any abusive practice by either plaintiffs or their licensing agent which would deny them copyright protection (R. 35, Mem. Opin. p. 5).

3. The defendants failed to take licenses not because they feared state prosecution and did not want to violate state law, but that they failed to take licenses only to avoid paying license fees (R. 35, Mem. Opin. p. 5).

4. The licensing and policing of performances for profit can only be done by licensing organizations such as ASCAP, BMI and SESAC (R. 35, Mem. Opin. pp. 5-6).

5. The violations of plaintiffs of Washington law and the federal copyright and antitrust laws were minimal and the violations of the defendants unconscionable (R. 35, Mem. Opin. p. 6).

6. For at least ten years, each defendant regularly broadcast the musical compositions of plaintiffs and of other authors, composers and publishers for profit, without the payment of royalty or compensation to any person (R. 37, Fact 8, p. 4).

7. The performances were made without regard to the rights of plaintiffs and other proprietors of the federal copyright law (R. 37, Fact 9, p. 4).

8. In radio broadcasting, split-second timing is necessary to selection of musical compositions for broadcast (R. 37, Fact 24, p. 7).

9. The licensing of public performances for profit of copyrighted musical compositions by licensing organizations such as ASCAP is the only practical way by which copyright proprietors may exercise their right to license performances of their copyrighted compositions, and that it would be impossible for a single proprietor to police the use of his copyrighted songs (R. 37, Fact 25, p. 7).

10. ASCAP has no power to fix license fees, since any user has the absolute right to have the court determine a reasonable license fee (R. 37, Fact 26, pp. 7-8).

11. Plaintiffs have at all times in the last ten years been ready to negotiate with any broadcaster in the state of Washington for a license (R. 37, Fact 50, p. 15).

12. In the last ten years, ASCAP has not received any request from any broadcaster in the State of Washington

and any ASCAP member in interest for the issuance of a license to perform one or more specific compositions (R. 37, Fact 51, p. 15).

13. Neither defendant nor any officers of any defendant corporation has ever been threatened with prosecution under Chapter 19.24, RCW. There is no evidence that any broadcaster in the State of Washington has ever been threatened, although the majority of Washington broadcasters have taken licenses from ASCAP, have paid royalties and have publicly participated in judicial proceedings to obtain such licenses (R. 37, Fact 55, p. 18).

14. Defendant's failure to take licenses from ASCAP was not because they feared prosecution under Chapter 19.24 RCW. Defendants failed to take licenses only because they wanted to avoid paying license fees on the same basis charged to—and paid by—other broadcasting companies (R. 37, Fact 66, p. 18).

15. No Washington public official has made any complaint that ASCAP's per program license does not assess rates on a per piece system of usage (R. 37, Fact 52, p. 16).

16. There is no evidence that plaintiffs or other members of ASCAP have entered into a conspiracy to prevent recording companies from obtaining licenses authorizing broadcasting stations to perform publicly for profit any musical composition (R. 37, Fact 75, p. 19).

17. Each member of ASCAP may assign or license performing rights to recording companies (R. 37, Fact 69, p. 18).

18. The court erred in not finding all the facts which were stipulated to by the parties to be agreed facts and

made a part of the formal Pretrial Order (R. 30, Facts Nos. 9, 13, 19-22, 24-27, 29, 43-54, 56-57, 59-63, 67-70, 73-74, 79-87). As stated above in the preface, each of the facts stipulated to by the parties, but omitted from the trial court's findings, are set forth verbatim in Appendix "A."

19. The court erred in not finding the admitted facts taken from Plaintiffs' Answers to Defendants' Request for Admissions, which were agreed by the parties to be stipulated facts and made a part of the formal Pretrial Order (R. 30, Admissions Nos. 1-2, 26, 29, 32, 34, 36). As stated above in the Preface, each of the Admissions stipulated to be facts, but omitted from the trial court's findings, are set forth verbatim in Appendix "B."

20. The court erred in not finding as facts those which were set forth in the Pretrial Order as "Defendants' Contentions of Fact" (R. 30, Contentions Nos. 1-9, 12, 14-26, 28-32, 34-41, 50-53, 59-69). As stated in the Preface, each of these contentions is set forth verbatim in Appendix "C."

21. The court erred in not finding that the defendants relied on and were guided by statements of the attorney general and his assistants that the licenses offered by ASCAP violated Washington State Law, Chapter 19.24, and in particular the statements contained in his letter dated June 8, 1962, Def. Ex. No. A-14.

The court erred in making the following conclusions of law:

22. During the last ten years, defendants have committed numerous other infringements of plaintiffs' copyrighted musical compositions and of the copyrighted musical compositions of other authors, composers and publishers (R. 37, Concl. 3, p. 2).

23. Defendants' defenses based upon Ch. 19.24, RCW, are without merit and cannot be used to defeat plaintiffs' claims for copyright infringement (R. 37, Concl. 5, p. 21).

24. In consequence of ASCAP's filings with the Secretary of State of the State of Washington in each of the last three years, ASCAP and its members have fully complied with the provisions of 19.24.040, 19.24.050 and 19.24.055, RCW (R. 37, Concl. 6, pp. 21-22).

25. By bringing lawsuits against infringing broadcasters in the State of Washington, neither plaintiffs nor other ASCAP members have violated 19.24.050, RCW. No abuse of federal or state process results from plaintiffs bringing the present actions to compel infringing broadcasters to honor plaintiffs' rights under the Copyright Law nor from writing letters demanding that their rights be respected (R. 37, Concl. 7, p. 22).

26. Plaintiffs and other ASCAP members have not pooled their separate copyrighted interest in ASCAP for the purpose of fixing prices in violation of 19.34.020, RCW (R. 37, Concl. 9, p. 22).

27. The ASCAP "per program" license may reasonably be regarded as assessing rates "on a per piece system of usage" as the Washington statute uses that phrase. The willingness of ASCAP's individual members to negotiate for licenses containing rates assessed on a per piece system of usage also constitutes compliance with the statute (R. 37, Concl. 11, p. 23).

28. ASCAP and its members fully comply with the requirements of 19.24.020, RCW (R. 37, Concl. 12, p. 23).

29. Defendants' contentions as to the requirements of

Ch. 19.24, RCW, would deprive plaintiffs and all other copyright owners of their federally granted property rights (R. 37, Concl. 13, p. 23).

30. To construe the provisions of Ch. 19.24, RCW, so as to make the acts of the plaintiffs or ASCAP in these cases unlawful, would raise grave questions concerning the constitutionality of the Washington statute under the Fourteenth Amendment to the Constitution of the United States (R. 37, Concl. 14, p. 23).

31. Defendant's defenses and counterclaim based on the federal anti-trust laws are without merit (R. 37, Concl. 15, p. 23).

32. Plaintiffs have not unlawfully extended their copyright monopolies through a combination among themselves or with ASCAP, nor are they guilty of violating the federal anti-trust laws in any respect alleged by defendants or otherwise (R. 37, Concl. 16, p. 23).

33. In view of the rights granted to defendants by Section IX of the Amended Final Judgment, defendants cannot complain that they have been damaged or prejudiced by ASCAP's conduct (R. 37, Concl. 15, p. 23).

34. Neither plaintiffs nor other members of ASCAP have entered into a conspiracy to prevent recording companies from obtaining licenses authorizing any broadcasting station to perform publicly for profit any musical composition (R. 37, Concl. 18, pp. 23-24).

35. Even if plaintiffs' conduct in any respect could be considered a violation of either Washington law or the federal anti-trust laws, such violations are so minimal and the violations of the defendants so unconscionable that

plaintiffs should not be deprived of the right to maintain these actions for the deprivation of their property (R. 37, Concl. 19, p. 24).

36. The plaintiffs are entitled to damages of $250.00 for each infringement, or a total of $1,000.00 (R. 37, Concl. 20, p. 24).

37. The plaintiffs are entitled to reasonable attorneys' fees and costs of $300.31 (R. 37, Concl. 21, p. 24; R. 11, Judgment ....).

The court erred in not making the following conclusions:

38. The conduct and acts of each of the plaintiffs, of ASCAP, and of the other members of ASCAP, were and now are in violation of the Washington Constitution and of Sections 3 and 7, Chapter 218 of the 1937 Session Laws of the State of Washington, RCW 19.24.020, RCW 19.24.060.

39. Neither ASCAP nor the plaintiffs have ever properly filed the list or other information as required by Washington laws.

40. By reason of each of the plaintiff's violations of the constitution and laws of the State of Washington, each of the plaintiffs has unclean hands and none has any legal or equitable standing to maintain this action.

41. By reason of each of the plaintiffs' acts and conduct set forth herein, each of the plaintiffs has unclean hands irrespective of whether such acts and conduct amount to statutory violation, and none has any legal or equitable standing to maintain this action.

42. Each of the plaintiffs, ASCAP and its other mem-

bers has conspired and combined to restrain trade and commerce among the several states of the United States in violation of the Sherman Act, (15 U.S.C. §§ 1, 2). The specific violations expressed in defendants' contentions of law (R. 30, No. 7 a-j are set forth verbatim in Appendix "D".

43. Each of the plaintiffs, ASCAP and its officers, directors, agents, representatives, members and all others acting on behalf of ASCAP and plaintiffs should be enjoined from continuing their unlawful activities in violation of the Sherman Act, 15 U.S.C. §§ 1, 2. The specific injunctive measures sought in defendants' contention of law in the Pretrial Order (R. 30, No. 8 a-i are set forth verbatim in Appendix "E".

44. By reason of each of the plaintiffs' violations of the anti-trust laws of the United States, each of the plaintiffs has unclean hands and none has any legal or equitable standing to maintain this action.

45. By reason of each of the plaintiff's acts and conduct, each of the plaintiffs has unclean hands irrespective of whether or not such acts and conduct amount to a statutory violation.

46. Defendants have no control or voice in the legal proceedings between the United States and ASCAP and its members, and have no control or influence over the consent decree. Said consent decree cannot deprive defendants of the protection afforded them by Washington laws or by federal anti-trust laws, nor deprive defendants of their rights thereunder.

47. As here sought to be applied by plaintiffs, the

Amended Final Judgment of March 14, 1950, would deprive the defendants of their property without due process of law.

48. The defendant is entitled to a new trial to introduce newly discovered evidence, namely, the letters from advertising agency refusing to allow radio stations, including one of the defendants, to have an advertising order unless the stations had an ASCAP license.

49. The defendant is entitled to a new trial on the grounds of newly discovered evidence and material, discovered since the trial, and which could not have been obtained before the trial by the exercise of reasonable diligence.

50. Plaintiffs' actions for damages and injunction herein are barred by laches.

51. Defendants are entitled to damages, attorneys' fees and costs.

ARGUMENT

Summary of Argument

The appellees are misusing their copyrights and abusing the copyright privileges granted to them by Congress. In doing so they are unlawfully extending their copyrights, violating public policy of Washington State and Congress, and violating specific laws of Washington State and the federal antitrust laws. Such misuse of their copyright privileges bars the appellees, as copyright owners, from obtaining relief for copyright infringement from the appellant.

Furthermore, appellees' violations of the federal antitrust laws have damaged and otherwise injured the appel-

lant and other users of music. Such damage and injury afford the appellant a right of action against the appellees under Sections 4 and 16 of the Clayton Act (15 U.S.C. §§ 15, 16) for damages, attorneys' fees, costs and, most important, injunctions to correct the abuses.

The Statutes Involved

The texts of all statutes involved are set out verbatim in Appendix "F."

Introduction

This case is of extreme importance to two industries—the music industry and the broadcasting industry. The problems have been festering for over three decades. What will be decided runs deeper than whether the Washington State statute is a defense or whether appellees have violated the Sherman Act. The substance of what will be decided is whether the copyright laws actually work primarily for the benefit of composers or primarily for the benefit of the public, and whether public policy that competition must remain free is for the music industry in fact real or illusory.

This case is a plea for free competition. The appellant is seeking the right to bargain for and buy music in a competitive and free market unfettered by artificial restraints (Tr. 26, 269, 304, 315, 317-318). (Please see Appendix "G" for text of testimony.) Appellee is powerless alone. Appellant must have and therefore seeks the aid of this court.

Music and the Public Interest

The Public Policy Behind the Copyright Law

The United States Constitution, Article I, Section 8 provides:

> "Congress shall have power . . . to promote the progress of science and useful arts by securing for limited times to authors and inventors the exclusive right to their respective writing and discoveries." U.S. Constitution, Art. I, Sec. 8.

On February 22, 1909, the Committee on Patents of the House of Representatives reported on the bill enacting the Copyright Act of 1909 which is the source from which all rights of appellees flow. The committee report declared the official policy behind the creation of copyrights and stated as follows:

> "The Constitution does not establish copyrights, but provides that Congress shall have the power to grant such rights if it thinks best. Not primarily for the benefit of the author, but primarily for the benefit of the public such rights are given. Not that any particular class of citizens, however worthy, may benefit, but because the policy is believed to be for the benefit of the great body of people, in that it will stimulate writing and invention to give some bonus to authors and inventors.
>
> * * *
>
> ". . . it has been a serious and difficult task to combine the protection of the composer with the protection of the public and to so frame an act that it would accomplish the double purpose of securing to the composer an adequate return for all use made of his composition and at the same time prevent the formation of oppressive monopolies, which might be founded upon the very rights granted to the composer for the purpose of protecting his interests." House Comm. Rep. on Bill enacting Copyright Act of 1909, to amend and Consolidate the Acts Respect-

ing Copyright, H.R. Rep. No. 2222, 60th Cong., 2d Sess. 7 (1909).

The above committee report makes it clear that the copyright laws are for the benefit of the public, not the composer, and that Congress, even in 1909, feared monopolistic abuses by copyright owners. This policy should be kept constantly in mind when determining the issues of this appeal:

> "The copyright law, like the patent statutes, makes reward to the owner a secondary consideration. In *Fox Film Corp. v. Doyal*, 286 U.S. 123, 127, Chief Justice Hughes spoke as follows respecting the copyright monopoly granted by Congress, 'The sole interest of the United States and the primary object in conferring the monopoly lies in the general benefits derived by the public from the labors of authors.' It is said that reward to the author or artists serves to induce release to the public of the products of his creative genius. But the reward does not serve its public purpose if it is not related to the quality of the copyright." *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 158, 68 S.Ct. 915, 92 L.Ed. 1260 (1948). Quoted with approval in *United States v. Loew's, Inc.*, 371 U.S. 38, 9 L.Ed.2d 11 (1962).

The appellees and ASCAP have turned the purpose of the copyright law around. The law is now being abused and employed primarily for the benefit of a few to exploit the many. Unless this court recognizes the evil and puts a stop to it, our courts will become a party to one of the slickest schemes devised to exploit a privilege beneficently bestowed.

The broadcast of music by radio stations is the general public's most immediate source of music and it is the principal medium through which music is transmitted. Any system which hinders the free broadcast of music

and restricts its availability to radio stations harms the public interest. Such repressions not only deprive the public of affluent availability, but the purpose of the copyright act to engender and stimulate the flow of music to the public is stymied.

The Public Policy Behind the State Law

In the State of Washington the public's interest has become the concern of the legislature, and it has been expressed in statute form.[9]

The Public Policy Behind the Anti-Trust Laws

The great public concern which is at stake here is the policy laid down by Congress that competition shall be and remain free. In the music licensing industry this policy has been made a joke by bright lawyers with ingenious schemes. The appellees and ASCAP have taken the privileges bestowed to them by the copyright law together with the benign parol of the consent decree and twisted them into a lucrative means of exploitation.

Basic to this appeal is an understanding of the clear and sound policy expressed time after time by the Supreme Court of the United States:

> "Basic to the faith that a free economy best promotes the public weal is that goods must stand the cold test of competition; that the public, acting through the market's impersonal judgment, shall allocate the nation's resources and thus direct the course its economic development will take." *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 605 (1953).

9. Session Laws of Washington, 1937, c. 218 § 6, RCW 19.24.060. See Appendix "F."

Section 1 of the Sherman Act provides:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal." 26 Stat. 209 (1890) as amended, 15 U.S.C. Sec. 1 (1958).

Section 2 of the Sherman Act declares:

> "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor." 26 Stat. 209 (1890), 15 U.S.C. Sec. 2 (1958).

Summary of the Criteria for Decision

To reemphasize, the basic public principles declared in the copyright act and the anti-trust laws are:

First. The purpose of the copyright laws is primarily to benefit the public, not primarily to benefit the copyright owner.

Second. The purpose of the anti-trust laws is to preserve free competition.

A complete understanding and acceptance of these two fundamentals is required to properly decide the issues in this case.

General Rules Applicable to Trial Court's Findings and Conclusions

This case was presented primarily on the agreed facts in the Pretrial Order (R. 30) and the depositions. The oral testimony at the trial was rather brief, and, in fact,

the appellees called only one witness. The trial court made rather extensive findings of fact, which makes this brief difficult to organize because of the interplay of the facts. Therefore the legal arguments made herein concerning the Findings of Fact and Conclusions of Law (R. 37) are meant to apply throughout this brief without unnecessary repetition.

Where the evidence presented is primarily in written form, such as documentary evidence and depositions, the appellate court is in as good a position to evaluate the facts as the trial court, and the trial court's findings of fact will not be given their usual weight.

> "In *Carter Oil Co. v. McQuigg* [CCA 7th, (1940) 112 F.2d 275] the court declared that a district court's findings of fact, where the testimony consists of documentary evidence and depositions, is 'subject to free review unaffected by presumptions which ordinarily accompany . . . findings on controverted issues.' A number of courts likewise have held that findings . . . on stipulated facts, on testimony taken by depositions, and in similar situations where credibility is not seriously involved or, if it is, where the reviewing court is in just as good a position as the trial court to judge credibility, are not binding on the appellate court and will be given slight weight on appeal." 5 MOORE'S FEDERAL PRACTICE 2637.

This is particularly true in this case where the trial judge, excusing his failure to write a substantive opinion, stated in his memorandum opinion:

> "I also concluded that such an opinion would be of limited value because there are practically no controverted issues of fact . . ." (R. 35, Mem. Op., p. 4)

As to the trial court's conclusions of law, the appellate court is not bound whatsoever:

> "This is clear both from the context of the rule and from long established principles both at law and in equity that the appellate court is, of course, not concluded by the trial court's view of the law. The requirement in Rule 52(a) that, in addition to finding the facts, the district court shall 'state separately its conclusions of law thereon' is to furnish the causal link between the facts and the judgment rendered. But in reviewing the judgment, so far as questions or conclusions of law are concerned, the appellate court is not concluded in any degree by the trial court's view of the law." 5 MOORE'S FEDERAL PRACTICE 2630-2631.

Because neither the Findings of Fact nor the Conclusions of Law are to be given much weight in this somewhat unique record, this brief will not belabor at length the particularities of the trial court's Findings or Conclusions.

The Trial Court's Failure to Find Facts Previously Stipulated by the Parties

(Specification of Errors 18 and 19)

After extensive efforts, many conferences, many arguments, extensive discovery, and, at the insistence of the trial court, the parties hammered out a lengthy and detailed pretrial order (R. 30).

The parties stipulated to a great number of facts in order to obviate the necessity of other proof at the trial. Yet, the trial court in its Memorandum Opinion (R. 35) and the Findings of Fact and Conclusions of Law (R. 37) arbitrarily selected only those facts most favorable to appellees and ignored finding those favorable to appellant. Thereafter, when challenged by the defendant on motions to amend and make additional Findings of Fact and Conclusions of Law (R. 44, 45), the trial court summarily

dismissed defendant's motion by the sweeping statement that the stipulated facts omitted were repetitious or irrelevant. (R. 48, p. 5).

This generalized and oversimplified conclusion is an error on the part of the trial court:

> "The pre-trial order, when entered, 'controls the subsequent course of the action, unless modified.' No proof need be offered as to matters stipulated to in the order, since the facts admitted at the pre-trial conference and contained in the pre-trial order stand as fully determined as if adjudicated at the trial. This is true, even as to jurisdictional facts." 3 MOORE'S FEDERAL PRACTICE 1126-1127.

Of the many stipulated facts ignored by the court in its findings, appellant, for the sake of brevity, will show here the relevancy of only a few as examples. Rather than argue the relevancy of each of the facts here, appellant suggests the relevancy of all of the omitted stipulated facts will become apparent as they appear and are relied upon in the brief. Appellant respectfully asks the court to recognize the facts as they are referred to by numbers throughout this brief.

Some of the most obviously relative stipulated facts omitted are:

1. "The ASCAP repertory includes more than a million musical compositions." (R. 30, Fact 13, p. 3; Appendix "A," No. 18-1.)

This fact is relevant to show the vast size of the ASCAP copyright pool on the issues of power to control prices, power to require licenses, necessity to broadcasters, consideration of copyrights, monopoly, control of market—all possible violations of the Sherman Act

(Secs. 1, 2). It is sufficient to cite the most recent case where the extent of the pool was relevant. See *Hazeltine Research, Inc., v. Zenith Radio Corporation,* 239 F. Supp. 51 (1965).

2. "The affairs of ASCAP are managed by its Board of Directors, the members of which are elected by the members of ASCAP. The fee to be quoted for any license of the ASCAP repertory is initially determined by the Board of Directors, as distinguished from its members." (R. 30, Fact 24, p. 6; Appendix "A," No. 18-7.)

That the license fee is determined by group action goes to the issue of price fixing and the per se rule. *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927), and other cases cited *infra.*

3. "In the last ten years, neither ASCAP nor any plaintiffs have entered into any license agreement with any broadcasters located in the State of Washington on any other basis than the forms [Per Program and Blanket License] and similar forms." (R. 30, Fact 26, p. 6; Appendix "A," No. 18-9.)

Again this fact goes to the issue of price fixing and is evidence of conspiracy to peg prices within a stabilized range. *United States v. Socony-Vacuum Oil Co.,* 310 U.S. 150 (1940); *United States v. Masonite Corporation,* 316 U.S. 265 (1942).

4. "Music is a necessity to the broadcasting industry in the State of Washington and throughout the United States." (R. 30, Fact 45, p. 9; Appendix "A," No. 18-14.)

This is relevant to the issue of competition and control, to the issue of the public interest affected, to tying agree-

ments, block booking and much more too obvious to mention. *Alden-Rochelle, Inc., v. ASCAP*, 80 F.Supp. 888 (1948); *M. Witmark & Sons v. Jensen*, 80 F.Supp. 843 (D. Minn. 1948); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948), and other cases cited later in this brief.

5. "Each musical copyright is unique." (R. 30, Fact 61, p. 11; Appendix "A," No. 18-28.)

The uniqueness of the tying product is essential to the issue of tying agreements. *United States v. Loew's, Inc.*, 371 U.S. 38 (1962), and other cases too numerous to repeat the citations here, but cited and relied upon later in this brief.

6. "ASCAP makes per program licenses available to all broadcasters; fewer than 60 to 100 broadcasters in the United States [out of the approximately 5,500 in existence] elect that form of agreement. At the time of the alleged infringement and now, none elect that form in Washington." (R. 30, Fact 62, p. 11; Fact 57, p. 11; Appendix "A," Nos. 18-29, 18-25).

This shows the unreasonableness of the alternative to the standard Blanket License form offered. See *Hazeltine Research Inc., v. Zenith Radio Corporation*, 239 F.Supp. 51 (1965), pages 69-78.

> "Although it may be said that the Hazeltine proposals on the surface were offers to treat of individual patents, the design was quite apparent—to force by unlawful coercion the acceptance of unwanted patents. This constituted an illegal extension of the patent monopolies." *Hazeltine Research, Inc. v. Zenith Radio Corporation*, 239 F.Supp. at 77.

7. "ASCAP does not offer licenses to broadcasters

such as western, religious, 'good music,' classical, 'top 40.'" (R. 30, Fact 82, p. 14; Appendix "A," 18-45.)

Again, this is relevant to abuse of the copyright privilege and misuse of power gained from pooling. Competition is stifled because only one form of license is offered—all or nothing. Comparing the *Zenith Radio* case, *supra,* the above is all the more relevant. There the patent owner at least offered specialty lines from the patent pool, but the court held this too was only an illusory offer to force Zenith ". . . to accede to Hazeltine's demand and accept a full package license." *Id.* at 71. The above fact shows ASCAP does not offer a real or reasonable choice of licenses. This is relevant to misuse of copyrights.

8. "The performance rights to some music in ASCAP's repertory is vastly more valuable than the performance rights to other music in ASCAP's repertory, and of all the millions of musical compositions copyrighted very few become hits or of any significant value. This is also true of the performance rights to music written by plaintiffs." (R. 30, Fact 83, p. 14; Appendix "A," 18-46.)

"The revenue distributed by ASCAP, pursuant to the consent decree, to its members from performance rights fees cannot be segregated to determine how much money is distributed for any particular composition." (R. 30, Fact 84, p. 14; Appendix "A," 18-47.)

Appellant fails to see how two facts could be more relevant to this case than the above. The courts agree. Simply reading the *Alden-Rochelle* and *Witmark* cases, *supra*, makes this obvious. To repeat the issue, the antitrust laws make it illegal to license or treat unique copy-

rights like fungible goods or so many bushels of wheat. When this was done in the *Zenith* case the court stated the rule which the present trial court ignored completely:

> "The reward sought by plaintiff from defendant for inventions to be licensed is in no way related to the quality of the individual patents and under the package license each patent drew strength from others, thus unlawfully extending the monopoly of each." *Hazeltine Research, Inc., v. Zenith Radio Corporation,* 239 F.Supp. at 77.

Again:

> "Moreover, the reward demanded by plaintiff for a license under less than the full package of patents is no way related to the quality of the patent . . ." *Id.* at 72.

With the above as examples, it should be immediately apparent that the trial court's indiscriminate generalization that all the agreed facts it failed to find were irrelevant is error. In fact, appellant fails to understand how the trial court could have come to such a conclusion except by caprice or failure to understand the issues.

This is especially true where the trial court disallowed any cumulation of the evidence:

> "THE COURT: Let me make an announcement now. I think I ought to call to the attention of both of you the fact that you need not develop from live witnesses evidence that is stipulated.
>
> "If something was stipulated, it is not necessary to ask a witness about it, and, as to matters that have not been stipulated, if you ask a witness once and you get the right answer, you do not have to ask him that same question over again. You may proceed." (Tr. 199)

Then the trial court did an about face by not finding

as facts the stipulated facts and by not finding facts that were proved at the trial to which no controverting evidence was offered.

Even counsel for appellee agreed that the stipulated facts were uncontroverted:

> "MR. RIFKIND: Those things which we have stipulated to, of course we are bound by. We won't argue about that. We have negotiated out many stipulations." (Tr. 29)

Appellees Have Violated Washington Law

(Specification of Errors 2, 28, 38 and 39)

Issuing Blanket Licenses

(Specification of Errors 1, 21, 28 and 38)

In Washington it is unlawful:

> ". . . for two or more persons holding or claiming separate copyrighted works . . . to issue blanket licenses . . . for the right to commercially use or perform publicly their separate copyrighted works." RCW 19.24.020.

The language is clear. It required no construction. Blanket licenses are unlawful. There are no conditions—no qualifications to the statute. In fact, the language of the Washington law is so clear that appellant is dumbfounded at the trial court's decision that the appellees are not violating Washington law. One possible explanation is that the trial court confused later language in the section that allows copyright owners to pool their interests and fix prices on condition that they issue per piece licenses. But the statute does not say they may issue blanket licenses if they also issue per piece licenses.

Further, appellees do not deny they are "two or more

persons, holding or claiming separate copyrighted works," or that they "issue blanket licenses in this state, for the right to commercially use or perform publicly their separate copyrighted works" (R. 30). In fact, appellees admit and have stipulated in the Pretrial Order that they issue blanket licenses (R. 30, Facts 19, 22, 62 and 69).

In addition to radio and television blanket licenses, ASCAP and appellees through ASCAP offer twenty other types of blanket licenses in Washington State (Def. Ex. 7, Def. Ex. 8, Def. Ex. 8-A, Plt. Ex. 6). Under the statute, to issue these licenses is to violate the law. This is true, regardless of whether or not appellees also offer per-piece licenses. The Washington State Attorney General has so stated.

> "You have asked, by your recent letter, whether the issuance of 'blanket' licenses and 'per program' licenses (a form of 'blanket' licenses) by an association of holders of copyrights for musical compositions violates Chap. 218, Laws of 1937 (RCW 19.24), and whether licensees signing such licenses are subject to the sanctions of the statute.
>
> "It appears from the plain wording of the statute that it is unlawful for such associations to issue such licenses." Letter dated June 8, 1962, from John J. O'Connell, Attorney General, State of Washington, to Senator Albert C. Thompson, Jr. (Def. Ex. A-13)

The fact that in 1959 Judge Ryan signed an order containing a pre-agreed statement that the licenses could be lawfully entered into is of little consequence (R. 6, Pl. Reply Ex. "D"). The order was submitted to the court for signature upon negotiated agreement of the parties (R. 30, Pretrial Order, Agreed Fact 74). The defendants were not parties to those negotiations or that order (R. 30, Pretrial Order, Agreed Fact 28). It was

submitted to the court for signature without the benefit of testimony, affidavits, memoranda, briefs, or any argument by lawyers. It was limited to those parties, at that time, a mutual agreement to remedy that specific situation, under the conditions then facing the parties—no more, no less. It was a settlement of differences dictated by the parties thereto, and it cannot bind one not a party. *Sam Fox Publishing Co. v. United States,* 366 U.S. 604 (1961).

Faced with the overpowering ASCAP repertory and ASCAP's refusal to issue licenses, the broadcasters would have signed almost anything (R. 30, Fact 73).

Pooling Copyrights, Fixing Prices and Collecting Fees

(Specification of Errors 11, 15, 18-24, 27, 39)

In Washington it is also a crime for two or more persons holding or claiming separate copyrighted works,

(1) "to band together, or to pool their interests for the purpose of fixing the prices on the use of said copyrighted works," or

(2) "to pool their separate interests" or

(3) "to conspire, federate, or join together for the purpose of collecting fees in this state,"

unless per piece licenses are issued (RCW 19.24.020). The statute states: "Such persons may join together if they issue licenses on rates assessed on a per piece system of usage" (RCW 19.24.020). See *Taylor v. State,* 29 Wn. 2d 638, 188 P.2d 671 (1948); *Buck v. Gallagher, supra,* at 99). Thus copyright owners may band together, may pool their interests and may conspire, federate and join together, provided they issue per piece licenses.

What is a "per piece" license, or, as the statute says, "a license based upon a per piece system of usage?" A per piece license is a license where rates are assessed "... on a basis of so much money per each time a piece of music is played or used in a public performance for profit" (RCW 19.24.140).

Plaintiffs' licenses entitled "Washington Local Station Per Program License" are not per piece licenses (Def. Ex. 7, 8, 8-A). The rate for these licenses is based upon adjusted gross income derived from all programs using ASCAP music. The rate is an unreasonable 8%[10] of the gross revenue from the program, whether one ASCAP song is played or ten seconds of one song or ten songs or twenty songs or any number of songs. This is a far cry from "so much money per each time a piece of music is played." By signing such a license the licensee gets a blanket right to use the entire repertory—a full package —and pays on gross revenue. This is not so much money each time a piece of music is played. (See the previous section "ASCAP Licenses," *supra.*)

It is preposterous for appellees to assert that the per program licenses are per piece licenses. In the first place, Mr. Herman Finkelstein, Chief Attorney for ASCAP, has stated on several occasions under oath that per program licenses offered by ASCAP are blanket licenses:

> "Both the program license and the blanket license are blanket licenses, that is the user has the right to use everything in the repertory without getting any special permission; by merely entering into the licensing agreement the broadcaster has a right to

10. Just how unreasonable is shown by the fact that of over 5,000 broadcasters in the United States fewer than 100 have the "Per Program" license. (R. 30, Agreed Fact 62, p. 11, Agreed Fact 57, p. 11.)

use everything . . ." Statement of Herman Finkelstein, September 18, 1956, Hearings Before the Antitrust Subcommittee (Committee No. 5 of the Committee on Judiciary of the House of Representatives, 84th Cong., 2nd Sess., Part 2, Volume 2).

"The radio station or network or the television station or network has its option to take a license on a blanket basis or what is called a per program basis that is still a blanket basis but the payment is in relation to those programs which use music in the ASCAP repertoire." Hearings Before the Subcommittee on the Select Committee of Small Businesses on the Policies of ASCAP, 85th Cong., 2nd Sess. 21 (1958). (R. 30, Def. Ex. 48.)

Mr. Timberg was not confused by the label "Per Program." He said:

"ASCAP licenses only the pooled aggregate of the performing rights assigned to it by its member, i.e., its entire repertory. It licenses that aggregate for specific industrial uses—radio broadcast, dance hall or symphony concert—but its licenses always convey a blanket authorization to the licensee to use its entire repertory; it never licenses the right to perform individual pieces, or individual publisher's catalogues, or any part of its repertory." Timberg, 297.

* * *

"As a matter of linguistic purity, all ASCAP radio licenses are blanket licenses in that they entitle the station to use the entire ASCAP repertory." Timberg, 310.

The Attorney General of the State of Washington states that per program licenses are blanket licenses and that it is unlawful for ASCAP, or plaintiffs through ASCAP, to issue such licenses. (See letter, June 7, 1962, from Senator Albert C. Thompson, Jr., to John J. O'Connell, Attorney General, and letter, June 8, 1962, from John J. O'Connell, Attorney General, in reply (Def. Exs.

A-13, A-14). (See also Attorney General's Opinion, Nov. 3, 1941, Def. Ex. A-50.)

The trial court's finding that the appellees, as individual copyright owners, have always been ready to issue licenses on a per piece basis to broadcasters, and this satisfies the statute, is error (R. 37, Concl. 11, p. 23).

The statute requires that copyright owners file a complete list of the prices demanded for their works.

> ". . . a complete list of their copyrighted works together with a list of the prices charged and demanded for their various copyrighted works shall be filed . . ." RCW 19.24.040.

> "No person . . . shall be absolved from the foregoing duty of filing said list of holdings as required in the preceding sections of this act, if their music or copyrighted works are used commercially in this state . . ." RCW 19.24.055.

ASCAP's members (including appellees herein) have never filed individually under the state law. They have never shown they offered "per piece" licenses to broadcasters by filing one with the Secretary of State. They cannot at the trial therefore assert they were willing to offer them if only asked. This is hindsight and a sham.

If the filings made by ASCAP with the Secretary of State (Def. Ex. 7, 8, 8-A) do not purport to list all rates offered, charged, or demanded by its members, or if they do not purport to be filed for the members, then ASCAP's members either (1) have not filed as required, or (2) have not made a complete filing as required. Both omissions are violations.

The fact is, of course, that appellees individually have no per piece agreements. In fact, as the depositions show,

most of the appellees did not even know that the Washington law requires them or even what they are (Def. Ex. A-31(a), Deposition of Herman Starr, pp. 31-33; Def. Ex. A-31(c), Deposition of Carolyn Leigh, pp. 16-17; Def. Ex. A-31(c), Deposition of Irving Brown, p. 7).

It is also significant that whenever broadcasters wrote ASCAP asking for per piece licenses—which many broadcasters have done on numerous occasions—ASCAP did not even reply. (Def. Ex. A-15, A-16, A-17, A-18, A-19, A-20, A-21, A-22). (See Def. Ex. A-31d), Deposition of Louis E. Weber, pp. 12-14, 20.) The only conclusion defendants could assume by such silence is that none were available. For this reason it was stipulated that, if called as a witness, each defendant would testify that he did not ask for a per piece license from individual plaintiffs, because to do so would have been a useless and futile act (R. 30, Fact 27). Furthermore, several witnesses testified that defendants at all times have been ready to negotiate and pay fees on a per piece rate. But defendants could not negotiate for what was not available (Tr. 30, 31, 171, 202, 264, 265, 266, 268, 273, 284, 292, 301, 303, 313, 315).

Appellees also argued that if they or ASCAP offer at least *someone* a per piece contract, this satisfies the statute. This is a specious argument for the following reason. It was stipulated that the filings set forth the only forms of licenses which were and are made available by ASCAP in Washington, and that the filings do not contain any per piece licenses offered to broadcasting stations (R. 30, Facts 25, 28, 43 and 44). The single per piece license filed by ASCAP is in "Schedule 11, Schedule of License Fees for the Performance of Specific Compositions." The

title of the license itself states broadcasters are expressly excluded:

> "Schedule of License Fees for the Public Performance for Profit of Specific Compositions in the Repertory of the American Society of Composers, Authors and Publishers in Establishments *Other than Radio and Television Broadcasting Stations.*" (Def. Ex. 7, 8, 8-A, Schedule 11). (Emphasis added)

Appellees and ASCAP cannot circumvent the law by the neat device of offering one per piece license out of twenty-five and then barring the only users they in fact license from having it. This is violation of the spirit and letter of the law. It was clear error for the trial court to find "compliance" with the Washington law by this transparent device.

Appellant had the right to rely on the filings, and appellees should be estopped from now asserting that the filings did not reflect all the licenses that were available.[11]

It is clear that appellees, not having offered or issued per piece licenses to broadcasters in Washington, may not lawfully "join together" and the trial court's finding that the appellees stood ready to negotiate on a "per piece system of usage" is in error (R. 37, Fact 50, Concl.

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11. Appellees have misrepresented their offerings to defendants and the public. Omission, intentional or unintentional, is a misrepresentation to anyone who relied upon the filings to ascertain what licenses were available. Certainly, appellant had no knowledge or indication of any readiness on the part of appellees to negotiate or offer per piece licenses, or any licenses, for that matter. If ASCAP members seriously meant the per program license to be a per piece license, why did they not call it a "per piece" license? And when ASCAP "advised" broadcasters that they had better sign one of the two forms of blanket licenses, no mention was ever made of any other kinds of licenses being available—if in fact they were—which, for all practical purposes, they were not. (Def. Ex. A-24, A-43.)

6). Also, the court's conclusion that "per program" license may be regarded as a "per piece" license in compliance with the Washington Statute (R. 37, Concl. 11) is manifestly wrong.

Collecting fees

Appellees are violating the Washington statute in another respect. They are collecting fees in this state (R. 30, Facts 20, 23). As stated before, RCW 19.24.020 makes it unlawful for appellees to ". . . federate, or join together for the purpose of collecting fees in this state." ASCAP's Articles of Association state one of the purposes of ASCAP as follows:

> "Plaintiffs, together with the other members of ASCAP at all times pertinent hereto associated, as stated in the ASACP Articles of Association, for the following purposes, among others:
>
> "To grant licenses and collect royalties for the public representation of the works of its members." (R. 30, Fact 16)

The trial court found:

> "At all times pertinent, plaintiffs have received royalties . . ." (R. 37, Fact 54)

Further argument by appellant should not be necessary.

Pooling copyrights

It is incontrovertible that ASCAP's members are "pooling, federating and joining together." (R. 30, Facts 10, 18, plaintiff's membership in ASCAP; Facts 11-4, nature of ASCAP and its combined repertory of over one million, and R. 30, Facts 19, 20, 21, 23, 29, 69, issuing licenses and collecting fees.)

The trial court's findings of fact are that the appellees pool their rights (R. 37, Facts 15, 16, 17, 18, 19, 20, 21, 23). (See also Def. Ex. A-31g.)

Again, further argument should not be necessary.

Price fixing

(Specification of Errors 26)

The trial court's conclusion that appellees and other ASCAP members have not pooled their separate copyrighted interests for the purpose of fixing prices is in error (R. 37, Concl. 9).

The language of the statute does not require that prices be actually fixed, only that plaintiffs band together for the purpose of fixing them. It is incredible to urge that appellees, together with the other members of ASCAP, have not banded together for the purpose of fixing prices. Mr. Stanley Adams, ASCAP's President, testified ASCAP sets uniform prices (Def. Ex. A-31g, p. 59).

ASCAP is managed by a board of directors. ASCAP's Articles of Association, Art. IV and Art. V, pages 9, 15, state:

> "Powers of the Board of Directors:
>
> ". . . It is hereby expressly declared that the Board of Directors shall have the following powers, that is to say:
>
> ". . . to fix the rate, time, and manner of payment of royalties for performances of all works registered with the Society . . ." (*Id.* at Sec. 2, p. 15) (Def. Ex. A-4)

It has been stipulated that the board initially sets the fees to be charged:

> "The fee to be quoted for any license of the ASCAP repertory is initially determined by the Board of Directors, as distinguished from its members." (R. 30, Fact 24)

This is also the uncontroverted testimony of ASCAP's President, Stanley Adams (Def. Ex. A-31g, p. 13).

The point is that the members have federated or joined together "for the purpose" of collecting fees, and this is a violation of the Washington Act. The power to establish a particular rate is immaterial to the violation.[12]

Threats of Suits

(Specification of Errors 13, 14, 25, 29)

The Washington law also makes it a crime for the persons to use combined power to extort fees from and exploit citizens of the State of Washington. It is unlawful to use a:

> ". . . systematic campaign or scheme designed to illegally fix prices for the commercial use of copyrighted works in this state through the use of extortionate means and terrorizing practices based on threats of suits." RCW 19.24.060.

Federal courts also recognize that suits for infringement

12. The fact that appellees claim they stood ready to negotiate for a separate license and to deal individually is also immaterial to the charge of price fixing. This is a sham—a straw man. In *Taylor v. State, supra,* the court attached no significance to the fact that ASCAP had only the non-exclusive right to license its members' work and the members were free to deal individually.

> "It should be added that the members at the present time do not confer the exclusive power over their individual copyrighted compositions to ASCAP but may, under certain conditions, act for themselves individually." *Taylor v. State,* 29 Wn.2d 643.

See also the recent holding in *Hazeltine Research, Inc., v. Zenith Radio Corporation,* 239 F. Supp. 51 at 77.

> "Although it may be said that the Hazeltine proposals on the surface were offers to treat individual patents, the design was quite apparent—to force by unlawful coercion the acceptance of unwanted patents."

can be used as weapons to intimidate others and further existing monopolistic abuses. In a patent case where the plaintiff sued for infringement and the defendant counterclaimed for violation of the antitrust laws, the court in assessing treble damages for the defendant stated:

> "The trial court also found that the infringement action and incidental activities of Kobe were intended and designed to further the existing monopolistic purposes . . . The infringement action and related activities, of course, in themselves were not unlawful, and standing alone would not be sufficient to sustain a claim for damages which they may have caused, but when considered with the entire monopolistic scheme which preceded them. We think, as the trial court did, that they may be considered as having been done to give effect to the unlawful scheme . . . To hold that there was no liability for damages caused by this conduct, though lawful in itself, would permit a monopolizer to smother every potential competitor with litigation before it had an opportunity to be otherwise caught in its tentacles and leave the competitor without a remedy." *Kobe, Inc. v. Dempsey Pump Co.*, 198 F.2d 416, 425 (10th Cir. 1952) *certiorari* denied 344 U.S. 837, 73 S.Ct. 46, 97 L.Ed. 651 (1952).

In *Hazeltine Research, Inc. v. Zenith Radio Corporation*, 239 F.Supp. 51 (1965), the facts were very similar to the case at bar. There the plaintiff controlled a pool of television patents and forced the defendant to take a package license with fees based on gross revenues. The plaintiff filed numerous infringement suits against those ". . . who refused to sign its license agreement" (*Id.* at 70). The court in holding for the defendant recognized the coercive effect of infringement threats and suits:

> "It [the defendant infringer] was forced either to cease manufacturing and selling the television receivers, pay tribute with consequent increase in costs or incur the expenses incident to the defense of pro-

> tracted patent litigation. Although defendant's choice determined the nature and amount of the resulting damages, it was the necessity of having to choose that occasioned the injury." (*Id.* at 72.)

In judging that there was no abuse of federal or state process from plaintiffs bringing the present suits (R. 37, Concl. 7), the district court chose to ignore the Washington statute and refused to follow basic concepts of equity applied in the federal system.

Ample evidence is in the record of threats, coercion and a systematic scheme. The following findings of fact by the trial court are proof of a scheme: ASCAP is paying all expenses of these actions and the others which were settled (R. 37, Fact 55); ASCAP selected and retained the law firms (R. 37, Facts 55 and 56); ASCAP arranged to have stations monitored for infringements (R. 37, Fact 57) and continues to do so (R. 37, Facts 58, 59); ASCAP has authority to commence these actions and other actions (R. 37, Facts 60, 61); and to arrange for settlement (R. 37, Fact 62).

It is hardly a coincidence that in 1962, almost three decades after passage of the Washington law, nearly 100 copyright owners—all members of ASCAP—sued for infringement within a period of a few months. Clearly these circumstances show a "campaign or scheme." They also show "extortionate means and terrorizing practices."

In the eighteen months prior to the trial appellees and other ASCAP members brought 15 suits against 11 radio stations, alleging 272 infringements (R. 37, Fact 63). The potential liability to the small radio stations was staggering. Statutory damages alone could amount to $1,360,000.[13]

13. Statutory damages can be assessed at $5,000 per performance, The Copyright Act, 17 U.S.C.A. § 101(b).

It must be remembered that ASCAP is a combination of not merely a few copyright holders, but of over 8,800. When ASCAP commenced these suits it presented to the defendants the awesome picture of a combine with resources of over $36,000,000 a year and over a million copyrights. The sheer size of this combine is intimidating to any broadcaster.

Another striking piece of evidence is the tactics used against Wescoast Broadcasting Co. This company was a defendant in the cases consolidated for trial. It operates a radio station in Wenatchee, Washington. Immediately after refusing to sign an ASCAP license and settle suits pending against it, the company was sued for an additional 28 infringements on which statutory damages would not be less than $7,000 but could be $140,000 plus costs and attorneys' fees (R. 30, Pretrial Order, Plaintiff's Answer to Admission 26). $140,000 is as much as the station's gross income for a full year, and several times its entire profit (Tr. 304).

More evidence in the record is in Defendant's Exhibit A-43. On July 15, 1963, ASCAP's lawyer wrote several form letters to Washington radio stations demanding:

> "We have recently settled a number of copyright infringements in the Federal courts against Washington radio stations.
>
> "We have prepared a complaint against your station for playing copyrighted music for profit without the consent of the owners. We are authorized to offer you the same settlement terms, provided you indicate your acceptance of these terms within ten days from the date of this letter." (Def. Ex. A-43).

The most impressive evidence of intimidation was ASCAP's arbitrary refusal to license all radio stations lo-

cated in Washington in 1959 (R. 30, Fact 73). All broadcasters located in Washington were by a decision made in New York deprived of the use of over one million musical compositions combined in the largest music licensing repertory in the world!

Finally, one must ask why was one defendant, Rogan Jones, sued personally? By suing this individual, the appellees and ASCAP hoped to intimidate him by threat of loss of his personal assets into signing a license. They wanted to make him an example of what was in store for others who fought them. Whereas all other broadcasters were sued for only a few infringements, Mr. Jones was sued for scores of them. It takes no stroke of genius to realize that Mr. Jones had been singly selected for annihilation. If this is not evidence of a carefully plotted "systematic campaign" and "terrorizing practices" it would be difficult to know what else the legislature of Washington could have had in mind in using these words in its statute. Parenthetically, it should be noted that ASCAP succeeded in defeating Mr. Jones. The risk of having to pay the judgment of over $73,000 was too great and he signed an ASCAP license (R. 49, Settlement Agreement).

Appellees Have Misused Their Copyrights in Violation of Public Policy and the Federal Anti-Trust Laws

Specification of Errors 2, 20, 31, 32, 33, 35, 42

Introduction

The plaintiffs, through their conduct as described hereafter, are guilty of two distinct malpractices, either of which constitutes a defense, and either of which is grounds for injunctive relief and damages.

First. The plaintiffs are unlawfully extending their copyright monopolies. *Morton Salt Co. v. Suppiger,* 314 U.S. 488 (1942); *Hazeltine Research, Inc. v. Zenith Radio Corporation,* 239 F.Supp. 51 (1965); *M. Witmark & Sons v. Jensen,* 80 F.Supp. 843 (D. Minn. 1948) and cases cited therein.

Second. The plaintiffs are violating Sections 1 and 2 of the Sherman Antitrust Act, by pooling copyrights, price fixing, sharing fees, block booking, and monopolization of performing rights. *United States v. Loew's, Inc.,* 371 U.S. 38 (1962); *Northern Pac. R. Co. v. United States,* 356 U.S. 1 (1958); *United States v. Paramount Pictures, Inc.,* 334 U.S. 131 (1948); *International Salt Co. v. United States,* 332 U.S. 392 (1947); *Mercoid Corporation v. Mid-Continent Investment Co.,* 320 U. S. 661 (1944); *Hazeltine Research, Inc. v. Zenith Radio Corporation,* 239 F.Supp. 51 (1965); *M. Witmark & Sons v. Jensen, supra; Alden-Rochelle, Inc. v. ASCAP,* 80 F.Supp. 888 (1948); *Alden-Rochelle, Inc. v. ASCAP,* 80 F.Supp. 900 (1948).

Abuses of the patent and copyright privilege are classic violations. Early and late court decisions without exception condemn pooling copyrights and patents when licensing through a central agency which imposes competitive restraints, (See e.g., *United States v. Masonite Corp.,* 316 U.S. 265 (1942)) and tying agreements as in the *Loew's* case, *supra,* the *Zenith Radio* case, *supra,* and others cited before and hereafter.

A copyright owner is entitled to exercise the same rights that any other seller of property enjoys. But he cannot exercise his copyrights as a part of a larger plan to violate

the antitrust laws. He cannot do as appellees and the other members of ASCAP, namely pool and extend his single monopoly of a particular piece of copyrighted music to create another vastly larger and more powerful monopoly. *United States v. Loew's,* 371 U.S. 38 (1962); *M. Witmark & Sons v. Jensen,* 80 F. Supp. 843 (D. Minn. 1948); *United States v. Paramount Pictures, Inc.,* 66 F.Supp. 323 (SDNY 1946); appealed 334 U.S. 131. He cannot grant or refuse to grant licenses pursuant to an agreement with competitors—other copyright owners—to regulate competition. *United States v. Gypsum Co.,* 333 U.S. 364 (1948); *Standard Sanitary Mfg. Co. v. United States,* 226 U.S. 20 (1912).

In short:

> "Patents give no protection from the prohibitions of the Sherman Act to such activities, when the licenses are used as here, in . . . [a] scheme to restrain." *United States v. New Wrinkle, Inc.;* 342 U.S. 371, 378 (1952).

No additional authority is needed for the proposition that patents and copyrights are treated the same with respect to abuse of the privilege granted. See, however, *United States v. Loew's,* 371 U.S. at 46.

The very nature of ASCAP's organization, its activities and its methods are so inimical to the Copyright Act and the antitrust laws that ASCAP and its members have been constantly embroiled in litigation. This turmoil has resulted in two court decisions that are exactly like the case at bar. These cases are *M. Witmark & Sons v. Jensen* and *Alden-Rochelle v. ASCAP, supra.* In addition to these two cases, there are, of course, many more decisions involving misuse of copyrights and patents which are in point. This

will be discussed later, but of special significance are the very recent cases, *United States v. Loew's Inc.*, 377 U.S. 38, decided in 1962, and involving the offense of block booking of copyrights, and *Hazeltine Research, Inc. v. Zenith Radio Corporation*, 239 F. Supp. 51 decided in the Seventh Circuit in 1965, and involving patent pooling.

The defendant calls the above cases to the court's attention at this time because of their striking similarity to the present case and respectfully recommends that the court give them considerable study.

Turning now to the trial court's findings that appellees and ASCAP are not violating the antitrust laws or unlawfully extending their copyrights.

Unlawful Extension of Copyrights

Specification of Errors 32

Appellant respectfully points out the clearest cases illustrating unlawful extensions of the copyright privilege. These are *Morton Salt Co. v. Suppiger*, 314 U.S. 488 (1942); *Mercoid Corp. v. Mid-Continent Investment Co.*, 320 U.S. 661 (1944); *Hazeltine Research, Inc. v. Zenith Radio Corporation*, 239 F.Supp. 51 (1965); and *M. Witmark & Sons v. Jensen*, 80 F.Supp. 843 (D. Minn. 1948); *Alden-Rochelle v. ASCAP*, 80 F.Supp. 890 (1948).

No one can say it plainer than Chief Judge Nordbye in the *Witmark* case:

> "In view of the Court's finding that the copyright monopoly has been extended, it is not necessary to determine whether antitrust violations alone would deprive plaintiffs of the right to recovery . . .
>
> "It follows, therefore, from the premises that plain-

tiffs should be denied any recovery herein." *M. Witmark & Sons v. Jensen,* 80 F. Supp. at 850.

Judge Leibell also spelled out the violations in the *Alden-Rochelle* decision:

> "Many of the cases which held that patent owners may not combine their patents so as to extend the monopoly of the one patent by the monopoly of the other, state the legal principles which prevent two copyright owners from doing a similar thing. The leading cases, which hold that such a combination of patents constitutes an illegal restraint of interstate commerce, are reviewed in a recent decision, *United States v. Line Material Co., et al.,* 33 U.S. 287, 68 S.Ct. 550 (Quotation from case, which follows, is omitted herein.)" *Alden-Rochelle v. ASCAP,* 80 F. Supp. 890, 894 (1948).

Judge Goldberg said in 1962 in the *Loew's* case:

> "The antitrust laws do not permit a compounding of the statutorily conferred monopoly." *United States v. Loew's, Inc.,* 371 U.S. at 52.

Judge Austin said:

> "The reward sought by plaintiff from defendant for inventions to be licensed in no way related to the quality of the individual patents and under the package license each patent drew strength from others, thus unlawfully extending the monopoly of each." *Hazeltine Research, Inc. v. Zenith Radio Corporation,* 239 F. Supp. at 77.
>
> "Plaintiff's offer to license its patents individually but at royalty rates far in excess of the package rate was never an alternative to its controlling policy to grant defendant a license only under all of its patents . . . This constituted an illegal extension of the patent monopolies." *Ibid.*

It seems unnecessary to state that appellees in pooling their licenses with others, offering only package licenses,

and sharing fees, are clearly extending their copyrights unlawfully.

The Effect of the Per Se Rule

There are certain contractual restraints which are condemned by Section 1 of the Sherman Act without the necessity of any exhaustive analysis of the facts. Here the courts have no discretion. These kinds of restraints are considered so odious as to be per se unlawful. In other words, as the Supreme Court said in *Northern Pac. Ry v. United States, supra:*

> ". . . there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Northern Pac. Ry. v. United States,* 356 U.S. at 5.

Thus, agreements between competitors whose purpose is to fix prices and those of copyright licensors pooling their copyrights together are unequivocally banned without inquiry to their effect on competition or their justification. *United States v. Socony-Vacuum Oil Co.,* 310 U.S. 150 (1940); *United States v. Loew's, Inc., supra; Northern Pac. Ry. v. United States, supra.*

Notwithstanding the per se rule, the trial court in its findings attached great significance to the fact that the 1950 consent decree enables an applicant for an ASCAP license to petition the court to set a reasonable fee (R. 37, Fact 26, p. 7; R. 35, p. 4). The district court went on to say that pooling of copyrights and licensing through ASCAP is the only practical way for copyright owners to protect their rights (R. 37, Fact 25, p. 7). Appellees

also emphasized in argument to the court that because joint licensing is the only "sensible" way to market music that this justified all the appellees' conduct and excused their activities (Tr. 120-150).

The answer to these assertions is that the per se rule applies and the court may not inquire into the reasonableness of the rate. The rate itself is immaterial. Further, the consideration of commercial convenience to the copyright holder is also immaterial. Therefore, the trial court's decision so far as it is based upon these considerations is in error.

The reasonableness of rates is immaterial

Specification of Errors 9, 10

Price fixing under the Sherman Act is illegal per se. Absolutely no justification can be shown:

> "The reasonableness or unreasonableness of the rates does not militate against the absolute control of ASCAP to fix prices. The vice of the arrangement is apparent because, as the Supreme Court stated in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223, 60 S.Ct. 811, 844, 84 L.Ed. 1129, '. . . the machinery employed by a combination for price fixing is immaterial.'" *M. Witmark & Sons v. Jensen*, 80 F.Supp. 843 at 849.

The *Trenton Potteries* decision is the landmark case for the proposition that reasonableness is no excuse. Most later decisions cite and rely upon its mandate as their touchstone:

> "The aim and result of every price fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable

prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition secured by the agreement for a price reasonable when fixed. Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed and without placing on the government in enforcing the Sherman Law the burden of ascertaining from day to day whether it has become unreasonable through the mere variation of economic conditions. Moreover, in the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable. . . ." *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397-398 (1927).

Thus, the trial court's finding that apellants have an absolute right to petition the court for a determination of a reasonable rate is immaterial to this case. The pricing devices established by paragraph X of the consent decree (Def. Ex. A-2) may satisfy the Department of Justice, but they do not satisfy the Supreme Court.

The decree cannot by any stretch of the imagination sanction pooling arrangements in derogation of the law, or deprive appellants of their rights bestowed by the Sherman Act. Yet as being used today, it actually encourages these practices.

Convenience to the appellees is no excuse

Specification of Error 9

"To this defense the shortest answer is that the law does not allow an enterprise that maintains control of a market through practices not economically

inevitable, to justify that control because of its supposed social advantage [citing cases]. It is for Congress, not for private interests, to determine whether a monopoly, not compelled by circumstances, is advantageous. And it is for Congress to decide on what conditions, and subject to what regulations, such monopoly shall conduct its business." *United States v. United Shoe Mach. Corp.*, 110 F.Supp. 295, 345 (D. Mass. 1953), Aff'd, 347 U.S. 521 (1954).

"The necessities or convenience of the patentee do not justify any use of the monopoly of the patent to create another monopoly." *Mercoid v. Mid-Continent Invest. Co.*, 320 U.S. at 666.

In the most recent case, the court's ruling is quite clear:

". . . plaintiff cannot justify such use of the monopolies of patents, by arguing the necessities and convenience to it of such a policy." *Hazeltine Research, Inc. v. Zenith Radio Corporation*, 239 F.Supp. at 77.

"Whatever may be the asserted reason or attempted justification of Hazeltine, its efforts to compel defendant to accept a package of patents involved use of the patent or group of patents as a lever . . . Such a licensing scheme . . . is illegal. . . ." *Id.* at 77.

"If good business reasons and expressions of good intent would serve as a defense for restraining trade, the Sherman Act would be rendered impotent and would afford no aid to the free flow of commerce." *Id.* at 78.

In other words, inconvenience is the appellees' problem and not the courts' nor the appellant's, and again the trial court's emphasis and reliance on this feature is immaterial and in error.[14]

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14. We suggest, however, that appellees could police infringements through a cooperatively financed organization such as ASCAP, but without tying or coupling the protective efforts with unlawful pooling, price regulating, or sharing fees. A membership organization supported by dues could do the policing job.

Effect on competition

The effect of the per se rule is not only to declare commercial convenience and reasonableness of prices immaterial, it also has the effect of obviating the usual Sherman Act requirement of showing that the conduct in question has an adverse effect on competition.

> "Certain contractual restraints are usually condemned out of hand by the language of Section 1, without the necessity of any exhaustive analysis of the facts. Here the courts have little discretion. Restraints so presumed to be per se unlawful are those whose purpose or effect is solely to control the prices in or foreclose access to the market place. Thus agreements between competitors whose only purpose is to fix prices . . . and those of a licensor . . . unreasonably exercising leverage to tie a unique product to some other product have no objective other than to restrain trade and are necessarily banned if the language of Section 1 is to have any meaning. Again, transactions between competitors—regardless of primary purposes—whose principal effect is to cause an unnatural increase in the general level of prices in or arbitrarily to exclude other competitors from the market, in most cases are likewise viewed as undue restraints of trade which violate the section.
>
> "'. . . there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.'" Van Cise, Understanding the Antitrust Laws 24, 25 (1963), citing numerous cases for the above, and quoting *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

A landmark case could not state the rule more clearly or unequivocally:

> "Under the Sherman Act, a combination formed

> for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity . . . is illegal per se." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940).

In view of the above, the appellant is not required to show how appellees' conduct stifles competition. Nevertheless appellant will show later in this brief how in a real and practical way appellees' activities stifle competition.

Particular Violations of the Anti-Trust Laws

ASCAP and its members are violating Section 1 and 2 of the Sherman Act despite the consent decree. ASCAP and its members are:

(a) extending their copyright privileges;

(b) fixing prices and stabilizing rates between individual copyright members in licensing performance rights;

(c) excluding non-member copyright holders from the market;

(d) tying the license of desirable music to undesirable music and poor music to valuable music.

(e) forcing full package licensing, and offering illusory and unreasonable alternatives.

The *Witmark* and *Alden-Rochelle* cases clearly establish these activities as violations, and nothing in the 1950 decree pertaining to broadcasters has changed this. The facts of the two cases are so like those in the case at bar that defendants will quote them at length.

The *Witmark* decision

> "Plaintiffs in these cases are seeking (1) damages for alleged infringement by defendants of certain musical composition copyrights owned by plaintiffs, and (2) an injunction restraining future threatened

violation of these copyrights. Plaintiffs contend that defendants, who operate certain motion picture theatres, give public performance of those compositions for profit when showing certain films in their theatres without first obtaining from plaintiffs a license to perform publicly the compositions for profit. Defendants contend that plaintiffs are entitled to no relief upon the grounds that (1) plaintiffs have illegally extended their copyrights, and (2) plaintiffs' method of doing business is in violation of the Sherman Anti-trust Act, 15 U.S.C.A. § 1-7, 15 note. Unless these defenses can be sustained, it follows from the evidence that plaintiffs have established infringements of the musical copyrights referred to in the complaint and are entitled to an injunction, damages and counsel fees.

* * *

"There are some fifteen thousand theatres in the United States which obtain music performance rights from ASCAP. The performance rights of any musical composition controlled by ASCAP may be licensed singly, but it appears that ASCAP's copyrighted music is always licensed as a group under a blanket license from ASCAP. And while the copyright owners, including the plaintiffs herein, since the consent decree entered into in 1941 between ASCAP and the Federal Government may deal individually with anyone seeking a license for the performance of their composition publicly for profit, it seems that, in the licensing of the performance rights of the music integrated in a sound film, as a matter of practice theatre owners have but little opportunity to obtain licenses from the many individual copyright owners belonging to ASCAP who may have copyrighted music in the particular film purchased by the theatre owner. Defendants term the right of granting individual licenses by the individual ASCAP copyright owner as 'illusory' in that the motion picture theatre owner is generally required to buy his pictures for his theatre before he knows what copyrighted music may be contained therein. . . . and there is no deviation in the manner in which theatre owners obtain a license for the performance rights of copyrighted

> music. They all clear through ASCAP, and for years ASCAP has built up its business in this regard accordingly and with full knowledge of all of these circumstances. In fact, one of the witnesses, informed as to the methods of doing business in this regard, testified, and his testimony is not contradicted, that he had never heard of any theatre owner approaching anyone but ASCAP for performance rights where the music was copyrighted by an ASCAP member." *M. Witmark & Sons v. Jensen,* 80 F.Supp. at 844-845.

At this point it can be seen how similar the *Witmark* case is to the present case. The nature of the plaintiffs' actions and the defendants' contentions are identical. Both theatre owners and radio broadcasters must have ASCAP music (Tr. 165, 205, 264, 273). In both the copyright owner members of ASCAP could deal individually (R. 37, Facts 23, 24, 25, p. 7), and in both, as a matter of practice, they do not or will not. There is no deviation in the manner in which radio owners obtain performance rights licenses, and it is impossible for radio stations to contact copyright owners for individual licenses prior to playing each record (R. 37, Facts 24, 25).

Mr. Lincoln Miller testified, and the testimony is uncontradicted, that he has never heard of any radio broadcaster approaching anyone but ASCAP for performance rights (Tr. 165).

Continuing with Judge Nordbye's decision:

> "The United States Court of Appeals for this circuit has held in *Remick Music Corp. v. Interstate Hotel Co.*, (1946), 157 F.2d 744, at page 745, certiorari denied, 329 U.S. 809, 67 S.Ct. 622, 623, 91 L.Ed. 691, 1296, that the right to perform a composition publicly for profit and the right to record it are sep-

arate and independent rights.

* * *

"And because of the claimed right to split the licensing of the recording rights and performance rights, plaintiffs urge that the asserted extension of their copyrights is merely the copyright monopoly which has inured to them because of the advancement in the motion picture industry which has inaugurated sound films and devised the technique of integrating the sound script with the background of music and songs . . . By placing the control of performance rights for motion pictures in a Society maintained by them, they have obtained a potential economic advantage which far exceeds that enjoyed by one copyright owner. The power, although it may be argued it has been benevolently exercised in the past, nevertheless fully exists. Through ASCAP, these plaintiffs and their associates by a refusal to license, or by the imposition of an exorbitant performance license fee, can sound the death knell of every motion picture theatre in America. That it would not be good business economics for them to do so does not mitigate the economic advantage which these plaintiffs have obtained in addition to that which is granted to them by their lawful copyright monopoly. Free competition among the members of ASCAP to license individually their music is effectively curbed, if not completely obliterated, by the scheme of operation which the members of ASCAP have adopted . . . The pooling of all license fees obtained from the licensing of some 80% of all sound music in motion pictures and the sharing of the revenues thus obtained permit each copyright owner to enjoy the benefits obtained by other copyright owners. So it will be seen that plaintiffs have also tied their copyrights with other copyrighted music and thus have shared in the rewards which are obtained from other copyrighted material.

* * *

"Instead, therefore, of having a single monopoly of a particular piece of copyrighted music and the benefits which that might afford, every copyright

owner of music in ASCAP obtains the added economic power and benefit which the combined ASCAP control gives to them and their associates. Obviously, no one copyright owner would have the monopolistic power over the motion picture industry which ASCAP now enjoys.

* * *

"However free plaintiffs and their associates in ASCAP may have been from any design or intent to extend their copyright monopoly, or however beneficial it may be for them to carry on their business in this manner, or however inconvenient it may be for them to function otherwise, such facts and circumstances will not permit them to enlarge their lawful monopoly. As stated by the Supreme Court in *B. B. Chemical Co. v. Ellis*, 314 U.S. 495, 498, 62 S.Ct. 406, 408, 86 L.Ed. 367: "'. . . The patent monopoly is not enlarged by reason of the fact that it would be more convenient to the patentee to have it so, or because he cannot avail himself of its benefits within the limits of the grant.'

"It is the collective acts and agreements of plaintiffs and their associate members which have diverted their copyrights from their 'statutory purpose and become a ready instrument for economic control in domains where the anti-trust acts or other laws not the patent statutes define the public policy.' *Mercoid Corporation v. Mid-Continent Inv. Co., supra,* 320 U.S. at page 666, 64 S.Ct. at page 271. Refuge cannot be sought in the copyright monopoly which was not granted to enable plaintiffs to set up another monopoly, nor to enable the copyright owners to tie a lawful monopoly with an unlawful monopoly and thus reap the benefits of both.

* * *

"It seems undeniable that there is no competition among ASCAP members. Competition is effectually restrained because all licenses are granted by ASCAP under its control and domination. All earnings derived from licenses are pooled and divided among the members . . . And while it is contended that the

present rates arrived at in February, 1948, were acquiesced in by some twelve thousand motion picture exhibitors as being fair and reasonable and that they were willing to execute contracts with ASCAP thereunder, the price fixing power was nevertheless vested in ASCAP. The reasonableness or unreasonableness of the rates does not militate against the absolute control of ASCAP to fix prices. The vice of the arrangement is apparent because, as the Supreme Court stated in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223, 60 S. Ct. 811, 844, 84 L.Ed. 1129, '. . . the machinery employed by a combination for price fixing is immaterial. Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se.'

"It cannot be denied, therefore, that plaintiffs and their associates, acting in concert through ASCAP, fix prices and completely control competition and thereby restrained trade in violation of Section 1 of the Sherman Anti-trust Act which declares illegal 'every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states.' Moreover, it seems inescapable on this record that plaintiffs, through ASCAP, have achieved monopolistic domination of the music integrated in the sound films in the motion picture industry and have effectively monopolized that part of trade and commerce in violation of Section 2 of the Sherman Anti-trust Act." *M. Witmark & Sons v. Jensen*, 80 F.Supp. 847-850. (Emphasis added)

The *Alden-Rochelle* decision

"So that ASCAP might act for all its members most effectively, each member assigned to ASCAP the non-dramatic performing rights of his copyrighted musical compositions. The sums that ASCAP collected were kept in a common fund and a division of the proceeds, less expenses, was made at regular intervals. The division was one-half to the publisher

members, and one-half to the composer and author members.

"ASCAP is governed by a board of directors of 24 members. Prior to 1941 they were self-perpetuating, but since then 12 members are selected by the publishers and 12 by the composers and authors. The 12 who represent the publishers determine how the publishers' share of the fund shall be divided among the publishers; the 12 directors who represent the composers and authors perform a like service in allotting their respective shares to the composers and authors. From their determination there is a right of appeal to the Board of Appeal; and from its decision an appeal may be taken to the full board of directors.

"The division of the publishers' share among the publisher members is based upon the popularity, earning capacity, seniority and the number and quality of the compositions in a publisher members' catalog. Popularity or vogue is determined by a survey of the compositions played over certain broadcasting chains in a given period." *Alden-Rochelle v. ASCAP*, 80 F.Supp. at 891.

This is exactly the same procedure ASCAP follows today. See Articles of Association of ASCAP, Article IV and Article XV, Sec. 1(c) (Def. Ex. A-4).

As in the present case, the court also found that individual per piece licensing would be impracticable.[15]

15.

"A 'per piece' license would be commercially impracticable. Exhibitors frequently contract for films before they are produced. The 'cue sheets' for the film are made available when the picture is released for exhibition purposes. They list the musical compositions included in the picture. The extra labor and great expense of getting 'per piece' licenses for the musical compositions on a film is evident when we consider the film needs of an average neighborhood house, which exhibits two double feature shows weekly. Each feature contains parts or selections from about 20 musical compositions. Eighty per cent of the musical compositions on films is ASCAP music. That would require 64 'per piece' licenses a week, not in-

Nevertheless, in *Alden-Rochelle,* the court found that ASCAP and its members were in violation of both Sections 1 and 2 of the Sherman Act:

> "Almost every part of the ASCAP structure, almost all of ASCAP's activities in licensing motion picture theatres, involve a violation of the anti-trust laws. Although each member of ASCAP is granted by the copyright law a monopoly in the copyrighted work it is unlawful for the owners of a number of copyrighted works to combine their copyrights by any agreement or arrangement, even if it is for the purpose of thereby better preserving their property rights." *Ibid.*

The significance of *Alden-Rochelle* and *M. Witmark & Sons*

Faced with the rulings of *Alden-Rochelle* and *Witmark,* the conclusions of the trial court in this case that commercial expedience is an excuse and that the anti-trust laws have not been violated are incredible. If not, then the *Alden-Rochelle* and *Witmark* cases should be reversed and the principles upon which they are founded declared no longer the law.

ASCAP's price fixing in the broadcasting industry

(Specification of Error 10)

As previously established, not only does ASCAP's board of directors initially determine the fees charged (R. 30,

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cluding licenses for music which is used on newsreels and short subjects. Exhibitors naturally prefer a blanket license good for a year, covering all musical compositions controlled by ASCAP. For a 'per piece' license ASCAP charges $10.00, plus. For a yearly blanket license the cost to the average neighborhood theatre is less than $100. Not a single theatre ever requested a 'per piece' license from ASCAP." *Id.,* at 893.

Fact 24, p. 6), but it also determines the type of licenses which will be offered.

"Q. The Board of Directors of ASCAP initially determines the license rates for ASCAP's repertory *and the terms* of the licenses, doesn't it?

"A. Yes." (Def. Ex. A-31g, testimony of Stanley Adams, President of ASCAP.) (Emphasis added.)

This is a form of price fixing regardless of the exact rate of the fee.

Furthermore, Stanley Adams, President of ASCAP, testified:

(a) One of the primary purposes of ASCAP is to assure the member a uniform price for his work. (Def. Ex. A-31g, p. 59)

(b) The rate charged for music has nothing to do with the type of music used. (Def. Ex. A-31g, p. 61)

(c) There is one rate charged to all stations, regardless of the amount of music each uses, the kind of music each uses, or the quality each uses. (Def. Ex. A-31g, p. 61)

The consent decree only requires ASCAP to issue two types of licenses—blanket and per program. The decree does not require that ASCAP issue any other kind of license, and it does not state that these are the only kinds of licenses ASCAP can offer. See *United States v. ASCAP*, No. 13-95 Amended Final Judgment, Section VI. (Def. Ex. 2).

Judge Sylvester J. Ryan, in a 1962 proceeding under the 1950 decree, held that the court administering the consent decree was powerless to compel ASCAP to issue different types of licenses from the two called for. The court held Section IX deals only with the procedure for

determining reasonable fees, not types of licenses.

> "The entire Section IX, which speaks of a fee for the 'license requested' following application for a license . . . deals with the procedure for determining the reasonable license fees, not types of licenses. The words 'license requested' do not mean that an applicant for a license is given the right under the decree to compel ASCAP to give any type of license it demands and have the court fix the fee." *United States v. ASCAP*, In the Matter of the Application of Shenandoah Valley Broadcasting, Inc., Civil 13-95, *supra*.

Therefore, copyright owners, by their membership in ASCAP, in pooling their copyrights, are enabled through the selection of the form or type of license they chose to issue to in practical effect regulate and stabilize the prices at which they sell their copyrights. This is accomplished by refusing to calculate fees except by a percentage of gross revenues. All other kinds of licenses, such as per piece, licenses for specialty catalogues at reduced rates and clearance at the source by licensing recording companies, are denied. (See R. 30, Facts, 81, 82, 83, p. 14.)

ASCAP has effectively fixed the range within which music users can obtain licenses by formulating the type of license and the boundaries for assessments of fees.

> "Hence prices are fixed within the meaning of the Trenton Potteries Co. case if the range within which purchases or sales will be made is agreed upon, if the prices paid or charged are to be at a certain level or on ascending or descending scales, if they are to be uniform, or if by various formulae they are related to the market prices, they are fixed because they are agreed upon. And the fact that, as here, they are fixed at the fair going market price is immaterial." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 222 (1940).

In *United States v. Socony Vacuum Oil Co.*, it was held that price fixing can be accomplished in many ways, for example where

> ". . . the means for price fixing are purchases or sales of the commodity in a market operation or, as here, purchases of a part of a supply of the commodity for the purpose of keeping it from having a depressive effect on the markets . . ." *Id.* at 224.

Thus, the members of ASCAP have in concerted action agreed to offer only one form of license to broadcasters. This form calls for only one uniform method of payment, namely, on a selected uniform percentage of gross plus a uniform sustaining fee. This is price fixing pure and simple.

It has been stipulated, some stations desire and need only special styles or catalogues of music programming such as western, religious, "good music," classical and "top 40" (R. 30, Fact 81, p. 14). ASCAP does not offer licenses for special catalogues in order to satisfy these needs (R. 30, Fact 82, p. 14). Instead, by the bulk form of license ASCAP chooses to issue, broadcasters are required to subscribe to and pay for a catalogue of over one million compositions containing much music which is absolutely worthless to them. The vast portion of it is outdated, much of it is of a style most stations cannot use, most of it of inferior quality, and never had any value whatsoever for radio use (R. 30, Fact 83, p. 14).

Lincoln M. Miller, assistant president, Queen City Broadcasting Company, operator of KIRO, AM-FM and TV station, testified without contradiction as follows:

> "Q. So you believe that the blanket license you have today from ASCAP is significantly cheaper than

the cost would be to you then to take the kind of license you discussed?

"A. It is cheaper than that, certainly not higher. It is still—we are still paying for a lot of music we can't possibly use." (Tr. 173)

In *United States v. Masonite Corporation*, 316 U.S. 265 (1942), the defendants, who were patent holders, used cross-licensing agreements as the vehicle to pool their patents. The patent holders established a community device to sell their patented products. The method used was that each patent holder appointed the Masonite company to handle the sales of its products. As with ASCAP, Masonite set the initial prices and terms of sale.

The court in *Masonite* struck down the patentees' joint-selling device as a violation of the Sherman Act, saying:

> "Control over prices thus becomes an actual or potential brake on competition. This kind of marketing device thus actually or potentially throttles or suppresses competing and non-infringing products and tends to place a premium on the abandonment of competition . . . the power of this kind of combination to inflict the kind of public injury which the Sherman Act condemns renders it illegal per se. If it were sanctioned in this situation it would permit the patentee to add to his domain at public expense by obtaining command over a competitor. He would then not only secure a reward for his invention, he would enhance the value of his own trade position by eliminating or impairing competition. That would be no more permissible than a contract between a copyright owner and one who has no copyright, or a contract between two copyright owners or patentees, to restrain the competitive distribution of the copyrighted or patented articles in the open market." *United States v. Masonite Corporation*, 316 U.S. at 281-282.

The right to have the court set a reasonable fee under Section IX of the consent decree is illusory. In the first place, the *Socony-Vacuum Oil Co.* decision states:

> ". . . the machinery employed by a combination for price fixing is immaterial." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, at 223.

In the second place, it establishes an artificial method of price determination alien to the free play of the market place. By this device prices are not only stabilized within the rigid framework of the blanket formula ASCAP requires, but the actual fee imposed under these contracts is immediately insulated from competitive forces. Thus, copyright holders have neatly and effectively, under the guise of court supervision, pegged their prices within a given range and added the stabilizing influence of court administration.

For would-be users, the right to petition the court for reasonable fees is also illusory. The 1959 all-industry radio committee negotiations leading to determination of fees pursuant to paragraph IX of the decree took over a year and a half to complete. It is economically impossible for individual broadcasters to obtain a rate determination under paragraph IX. The legal fees alone would be more than the license fees defendants would have to pay for over a decade under the present forms of license.

Nor is appellant impressed with appellees' argument that after the 1950 decree the individual members of ASCAP have the right to license their music individually and all that ASCAP has is a non-exclusive right. This was no obstacle to Judge Nordbye or Judge Liebell:

> "In passing, it may be noted that the consent decree of 1941 permitting individual copyright owners

> to issue individual licenses for performance rights does not preclude a finding that ASCAP is in violation of the anti-trust laws in other respects." *M. Witmark & Sons v. Jensen,* 80 F.Supp. 843, 849.

The *Zenith Radio Corporation* decision is particularly appropriate to this argument. It opposes the trial court's conclusion that offering to license individual copyrights by individual owners (R. 37, Fact 25, p. 7; Fact 50, p. 15) and the fact that the license rights ASCAP has are non-exclusive justify the pooling device. (R. 37, Fact 21, p. 6)

In the *Zenith* case, the plaintiff sued for infringements, and defendant Zenith asserted that plaintiff was misusing its patents in violation of public policy and the Sherman Act, Sections 1 and 2, and it ". . . therefore, came into this court with unclean hands and is therefore barred from receiving any relief . . ." *Hazeltine Research, Inc., v. Zenith Radio Corporation,* 239 F.Supp. at 69. As in the present case, the plaintiff had through the years accumulated a huge number of patents for licensing the electronics industry. Royalties were required to be paid on the licensees' entire production, whether its products employed any or many of the plaintiff's patents. As in the present case, the license was in effect a covenant not to sue the licensee or its customers should the plaintiff determine there was an infringement. *Id.* at 69, 70. (Compare the standard ASCAP licenses, Def. Ex. 9.) During the course of attempting to have Zenith sign a full package license, the plaintiff offered several alternatives of less than full packages but at unrealistic rates. Zenith refused them all and was sued for infringement. (See various offerings by the plaintiffs, *Id.* at 70-72.) The court said of the various alternatives:

"Plaintiff's offer to license its patents individually but at royalty rates far in excess of the package rate was never an alternative to its controlling policy to grant defendant a license only under all its patents. Rather, it was proposed by Hazeltine in the later stages of its negotiations in the instant case to cloak the harshness of the original demand by seemingly meeting the request of defendant in that regard. Although it may be said that the Hazeltine proposals on the surface were offers to treat of individual patents, the design was quite apparent—to force by unlawful coercion the acceptance of unwanted patents. This constituted an illegal extension of the patent monopolies. Whatever may be the asserted reason or attempted justification of Hazeltine, its efforts to compel defendant to accept a package of patents involved the use of one patent or group of patents as a lever to compel the acceptance of a license under others. Such a licensing scheme under applicable decisions of the Supreme Court is illegal and constitutes a misuse of the patents involved." *Id.* at 77.

Blind selling practices and block booking

There is absolutely no way for a broadcaster to know at any given time whether a particular composition is in the ASCAP repertory. ASCAP's pool of over a million copyrights is far too vast for any individual broadcaster to cope with. ASCAP's repertory changes literally from minute to minute (R. 37, Fact 23, p. 7). Therefore, if a broadcaster signs one of the two forms of ASCAP blanket licenses he still doesn't have protection from infringement, which is the only value of the licenses.[16] These facts spell out a case of blind selling practices. These practices were condemned in the *Witmark* and *Alden-*

16. If records were cleared at the source by recording companies (which the ASCAP Membership Agreement prohibits, see argument later in this brief), there would be no problem. This is the practice in the movie industry, as a result of the *Witmark* and *Alden-Rochelle* cases, and the subsequent amendment of the consent decree in 1950.

Rochelle cases, about which cases enough has already been stated.

The *Witmark* and *Alden-Rochelle* courts also found ASCAP's members in violation of the Sherman Act for block booking activities.

> "By pooling their rights and pooling the license fees derived therefrom, each in some way shares in the copyrighted work of the others. This has all the evils of 'block booking' which was analyzed and condemned in *U. S. v. Paramount Pictures*, D.C. 66 F. Supp. 323 at pages 348-349, and in the opinion of the U. S. Supreme Court May 3, 1948." *Alden-Rochelle, Inc., v. ASCAP*, 80 F.Supp. at 895.

Appellees are still today pooling their rights and nothing has changed since these decisions.

A more recent pronouncement condemning block booking is the case of *United States v. Loew's, Inc.*, 371 U.S. 38 (1962). In the *Loew's* case the United States brought separate anti-trust actions against six major distributors of copyrighted movie films for television exhibition, alleging that each defendant had engaged in block booking in violation of Section 1 of the Sherman Act. The complaints asserted that the defendants had, in selling to television stations, conditioned the license or sale of one or more feature films upon the acceptance by the station of a package or block containing one or more unwanted inferior films.

As in the present case, the appellees claimed they offered licenses for individual films. In the *Loew's* case the television stations had indeed requested licenses for individual films. The court found the various offers to license individual films were actually illusory. (Cf. the *Zenith Radio* case, *supra.*)

This is the same situation that exists in the music industry. It would be a "useless and futile act" for appellant to request a per piece license (No. 30, Fact A.F. 27, p. 16). Making a request is not significant anyway, because, as noted in *Alden-Rochelle,* 80 F.Supp. at 893, "Not a single theatre ever requested a 'per piece' license from ASCAP."

Broadcasters on numerous occasions have requested per piece licenses from ASCAP and the reply has been silence (Def. Ex. A-15 to A-22, letters requesting per piece licenses). The fact is that there is not a single per piece license existing between any of the numerous appellees herein, or ASCAP, and any user of music in the State of Washington (R. 30, Fact 21, 26, 28, pp. 5, 6), and there aren't even any per program licenses (R. 30, Fact 62, p. 11). Whenever ASCAP writes broadcasters, no mention is made of the availability of per piece contracts (Def. Ex. A-24, being several letters from ASCAP to radio stations). More significantly, when ASCAP's and these appellees' lawyer threatened to sue several broadcasters in 1963, the demand was made that the station sign blanket licenses and no mention was made of the availability of per program or per piece licenses (Def. Ex. A-43).

Tying agreements

It has been stipulated in this case that each musical copyright is "unique" (No. 30, Agreed Fact 61, p. 11). In the *Loew's* case the court condemned tying agreements per se because of the unique nature of copyrights.

> "This case raises the recurring question of whether specific tying arrangements violate Section 1 of the

Sherman Act. This court has recognized that 'tying agreements serve hardly any purpose beyond the suppression of competition.'" *United States v. Loew's, Inc.*, 371 U.S. 38, 44 (1962).

A showing of market dominance is not required.

"The standard of illegality is that the seller must have 'sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product . . .' *Northern Pacific R. Co. v. United States*, 356 U.S. 1, 6. Market dominance—some power to control price and to exclude competition—is by no means the only test of whether the seller has the requisite economic power. Even absent a showing of market dominance, the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes." *Id.* at 45.[17]

Note that the court stressed both "uniqueness" and the product's "desirability to consumers."

"Since the requisite economic power may be found on the basis of either uniqueness or consumer appeal, and since market dominance in the present context does not necessitate a demonstration of market power in the sense of Section 2 of the Sherman Act, it should seldom be necessary in a tie-in sale case to embark upon a full-scale factual inquiry into the scope of the relevant market for the tying product and into the corollary problem of the seller's percentage share in that market. This is even more obviously true when the tying product is patented or copyrighted, in which case, as appears in greater

17. The *Loew's* action was instituted under Section 1 of the Sherman Act, because Section 2 was not needed. In the present case, however, both would be applicable because ASCAP has market dominance. The *Loew's* case involved only a few dozen films rather than over a million copyrights like ASCAP—more than 50 per cent of all performances by stations are compositions controlled by ASCAP (No. 37, Fact 18, p. 5), music is essential to stations (Tr. 6) and without ASCAP music stations would not be able to operate (Tr. 165, 205, 246, 273).

detail below, sufficiency of economic power is presumed." *Ibid*, footnote 4.

"The requisite economic power is presumed when the tying product is patented or copyrighted, *International Salt Co. v. United States,* 332 U.S. 392; *United States v. Paramount Pictures, Inc.,* 334 U.S. 131. This principle grew out of a long line of patent cases which had eventuated in the doctrine that a patentee who utilized tying arrangements would be denied all relief against infringements of his patent. *Motion Picture Patents Co. v. Universal Film Mfg. Co.,* 243 U.S. 502; *Carbice Corp. v. American Patents Dev. Corp.,* 283 U.S. 27; *Leitch Mfg. Co. v. Barber Co.,* 302 U.S. 458; *Ethyl Gasoline Corp. v. United States,* 309 U.S. 436; *Morton Salt Co. v. G. S. Suppiger Co.,* 314 U.S. 488; *Mercoid Corp. v. Mid-Continent Investment Co.,* 320 U.S. 661. *Ibid.* at 45 and 46.

In *United States v. Paramount Pictures, Inc.,* 334 U.S. 131, 156-159, the principle of the patent cases was applied to copyrighted films which had been block booked into movie theatres:

"It is said that reward to the author or artist serves to induce release to the public of the products of his creative genius. But the reward does not serve its public purpose if it is not related to the quality of the copyright. Where a high quality film greatly desired is licensed only if an inferior one is taken, the latter borrows quality from the former and strengthens its monopoly by drawing on the other. The practice tends to equalize rather than differentiate the reward for the individual copyrights. Even where all the films included in the package are of equal quality, the requirement that all be taken if one is desired increases the market for some. Each stands not on its own footing but in whole or in part on the appeal which another film may have. As the District Court said, the result is to add to the monopoly of the copyright in violation of the prin-

ciple of the patent cases involving tying clauses." 334 U.S. at 158.

The block booking practices of ASCAP completely thwart any possibility that each composition should stand on its own footing and command its own value in the market place.

Appellees, by maintaining membership in ASCAP, frustrate the purpose of both the copyright laws and the antitrust laws. For example, the two forms of ASCAP blanket licenses offered in this state include a "sustaining fee." This is a flat fee that is related to nothing. It is like a poll tax, or a penalty, and all music—good and bad—shares in the charge.

Appellees even admitted in the pretrial order that:

> "The performance rights to some music in ASCAP repertory is vastly more valuable than the performance rights to other music in ASCAP's repertory, and of all the millions of musical compositions copyrighted a very few become hits or of any significant value. This is also true of the performance rights to music written by plaintiffs." (No. 30, Fact 83, p. 14.)

How can appellees justify the existence of ASCAP practices, or even ASCAP, in view of this obvious violation—poor music sharing in the rewards which should go to good music—good music subsidizing bad music? After a running battle in the depositions on this point, appellees finally conceded that it was impossible to even tell how much of the ASCAP revenue was attributable to any particular music, or from where the money came regarding any particular music (R. 30, Fact 85, p. 14).

The argument that the so-called "Per Program" license offers a meaningful alternative is rendered invalid by the

Zenith Radio decision:

> "Moreover, the reward demanded by plaintiff for a license under less than the full package of patents is in no way related to the quality of the patents since the price is determined solely by the number of patents chosen and most of the patents in the package are characterized by Hazeltine itself as 'insignificant.'" *Hazeltine Research, Inc., v. Zenith Radio Corporation,* 239 F.Supp. at 72.

By appellees' own admission,

> ". . . of all the millions of musical compositions copyrighted a *very few become hits of any significant value.* This is also true of . . . music written by plaintiffs." (No. 30, Fact 83, p. 14.) (Emphasis added)

The *Loew's* case demonstrates that particularly where copyrights are concerned little latitude will be condoned:

> "There may be rare circumstances in which the doctrine we have enunciated under Section 1 of the Sherman Act prohibiting tying arrangements involving patented or copyrighted tying products is inapplicable. However, we find it difficult to conceive of such a case, and the present case is clearly not one. . . .
>
> "Enforced block booking of films is a vice in both the motion picture and television industries, and that the sin is more serious (in dollar amount) in one than the other does not expiate the guilt for either." Loew's, Inc., *supra,* at 49 and 50.[18]

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18. The court disposed of one trial court's points and an argument appellees make herein. Appellees contend that the individuals stand ready to negotiate with the broadcasters (R. 37, Fact 50, p. 15). This is nonsense as a practical matter. Appellees contend that, because of the illusory possibility that someone might sometime try to locate some of the over 8,000 members of ASCAP for separate licenses, their whole colossal tying agreement is somehow cleansed:

> "Appellants . . . make the additional argument that each of them was found to have entered into such a small number of illegal contracts as to make it improper to enter injunctive relief. Appellants urge that their over-all sales policies were to allow selective purchasing of films and that, in light of this, the fact that a few con-

The *Loew's* and *Zenith Radio* cases also dispose of the argument that the ASCAP bulk licensing arrangement is somehow necessary to the industry.[19]

> ". . . tying arrangements, once found to exist in a context of sufficient economic power, are illegal 'without elaborate inquiry as to . . . the business excuse for their use,' *Northern Pacific R. Co. v. United States*, 356 U.S. 1, 5." *Id.* at 51 and 52. (See also, *Hazeltine Research, Inc., v. Zenith Radio Corporation, supra.)*

Refusal to license performance rights with recording rights

(Specification of Errors 2, 16, 17, 20-24, 20-25, 20-26, 20-28(c), 33, 34, 42-9)

Particular contractual devices to restrain

ASCAP's members have in force mutual restrictive agreements making it impossible for other and new methods

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tracts were found to be illegal does not justify the entering of injunctive relief. We disagree. Illegality having been properly found, appellants cannot now complain that its incidence was too scattered to warrant injunctive relief. The trial judge, exercising sound judgment, has concluded that injunctive relief is necessary to prevent further violations." *Id.* at 50.

The foregoing case makes the present case *a fortiori*. Whereas the defendants in the *Loew's* case had many legal contracts and only a few illegal ones, the plaintiffs in relation to ASCAP have an immense tying agreement and virtually no competitive licenses.

Other reasons making the present *a fortiori* are: (1) ASCAP does not advise broadcasters that there are different licenses available to them, nor do appellees or other members of ASCAP (Def. Ex. A-24). (2) In Washington no other forms of licenses were filed with the Secretary of State as being available to broadcasters (R. 37, Fact 49, p. 15). (3) In the *Loew's* case film salesmen vigorously competed among themselves to sell their film lines, but ASCAP members never go into the field to sell their product (Def. Ex. A-31a, pp. 60-62).

19. We frankly don't know how anyone would know this since as far as broadcasters are concerned ASCAP preceded them and have never offered anything else as an alternative. ASCAP started doing business in 1914. By the time the broadcasting industry came on the scene ASCAP's economic power and market control was already complete. No alternatives could be tried or tested.

of marketing music to develop. The trial court found the following facts which were previously stipulated to by the parties:

> "Recording companies generally acquire only the recording rights to musical compositions." (No. 37, Fact 71, p. 19.)
>
> "At the time of the alleged infringement and now, there were and are no licenses in effect between ASCAP or any plaintiff and any recording company authorizing broadcasting stations to perform any musical composition publicly for profit." (No. 37, Fact 72, p. 19.)
>
> "ASCAP has never offered such to recording companies nor to defendants' knowledge has any such license ever been requested." (No. 37, Fact 73, p. 19.)
>
> "None of the plaintiffs has ever offered such licenses to recording companies nor to defendants' knowledge has any such license been requested." (No. 37, Fact 74, p. 19.)

ASCAP and its members control the rights of public performance of all musical compositions in ASCAP's repertory recorded with recording companies. This restraining feature, when applied to performance rights recorded or synchronized with movie films, was struck down by Judge Leibell in the *Alden-Rochelle* decree.

It is obvious why performance rights are not cleared at the source. This would require ASCAP's members to compete among themselves and bargain with recording companies on prices for clearance of performance rights. It was stipulated that composers and publishers actively compete to have their music recorded by recording companies and played by broadcasting companies (No. 30, Fact 70, p. 12). However, though there is competition

among ASCAP members to have their music recorded in the first instance, there is no competition to sell performance rights because these are split off from the recording rights and licensed in bulk. (See Appendix "G" for testimony of one witness which demonstrates the paradox of radio stations being urged to play music on the one hand and then being forced to pay for the favor.) Herman Starr, president of one of the largest copyright owning publishing houses in the world, Music Publishers Holding Company, testified the members are not allowed to bargain when it comes to performance rights and their prices. (Def. Ex. A-3/a Deposition of Herman Starr, pp. 60-62.)

This refusal to bargain is accomplished by the ASCAP pooling device. It is further augmented by tacit understandings among the members not to clear performing rights when records are sold,[20] and by certain express contractual arrangements described in the following pages. Before describing these arrangements, an expression of the requirements necessary to show conspiracy is appropriate. The *Zenith Radio* decision gives the most recent expression:

> "It is fundamental that an unlawful conspiracy may be and often is formed without simultaneous actions or agreement on the part of conspirators. Acceptance of an invitation to participate in a plan, the necessary consequence of which, if carried out, is to re-

20. During the trial Mr. Herman Finkelstein, General Counsel for ASCAP since 1943, testified that it is his business to be informed on all contracts negotiated and used in the music business, and that, accordingly, he knows that no contracts exist or have ever been requested which provide that a radio station would be authorized to perform musical compositions by a recording company (Tr. 333, 334). This is strong circumstantial evidence of a tacit understanding among members not to issue such licenses to recording companies and that it is Mr. Finkelstein's duty to keep track of these matters and to see that none of ASCAP's members do so license recording companies.

strain commerce, is sufficient to establish a conspiracy under the Sherman Act. Knowledge of a scheme that illegally restrains trade and participation in the plan without such knowledge is all that is required to establish a conspiracy under the antitrust laws and prior agreements need not be shown to have been made between each and all of the conspirators in order to establish a violation of the Sherman Act." *Hazeltine Rescant, Inc., v. Zenith Radio Corporation,* 239 F.Supp. at 77.)

"The character and effect of a conspiracy are not to be judged by dismembering it and viewing its separate parts but only by looking at it as a whole." *Id.* at 78.

The uniform popular songwriters contract

The Uniform Popular Songwriters Contract is the standard form of agreement used between composers and publishers. It contains this restrictive provision:

"All performance rights are . . . subject to any existing agreements between any of the parties hereto and the American Society of Composers, Authors and Publishers." (Def. Ex. A-12, 1947 revised agreement attached to Lew Brown-Elbee Production, Inc., contract, which has been stipulated as a standard form of agreement used in the industry today and by the appellees herein now.)

Standard form of recording contract

The standard clause found in agreements between ASCAP's members and recording companies expressly withholds performance rights thereby making it impossible for broadcasters to obtain performance rights with the purchase of records:

"This agreement is entered into with the understanding and agreement that nothing herein contained shall be deemed to free the phonograph rec-

ord manufactured pursuant to this license from further contribution to the copyright in the event of its being used for performance for profit." (See Def. Ex. A-41 and A-42, Forms of Agreement used by Chappell & Co., Inc., and Herman Starr's companies with recording companies, and stipulated to be the standard forms prevalent in the industry.)

Contracts with advertising agencies requiring ASCAP licenses

Another contractual device used to restrain competition among ASCAP's members is found in licenses with advertising agencies which record commercial radio jingles using copyrighted music.[21]

By insertion of the following clause in their agency contracts, the members of ASCAP refuse to clear the performance rights for broadcast and go one step farther. They prohibit the use of the commercial on a radio station unless the station has first obtained an ASCAP license:

> "All or any part of said musical composition when broadcast shall be broadcast only on radio and television networks and local stations having appropriate licenses therefor from the American Society of Composers, Authors and Publishers (ASCAP) in the United States, or the Composers, Authors and Publishers Association of Canada Limited (CAPAC), in Canada. Broadcasts of all or any part of said musical compositions over radio and television networks and local stations not licensed by ASCAP in the United States or CAPAC in Canada are subject to clearance of the performing rights from ASCAP, CAPAC, or

21. Some of ASCAP's members, including some of the plaintiffs herein, have received thousands of dollars from advertising agencies or other commercial users for the right to use one musical composition as a radio or television commercial (R. 30, Fact 57, page 23C). One advertising agency paid almost $100,000 for the right to use one song published by one of the plaintiffs as a commercial (R. 30, Fact 58, page 23C).

us." (Def. Ex. 38. Agreement between Music Publishers Holding Corporation and J. Walter Thompson Company, dated January 7, 1958, and stipulated to be an example of the kind of agreements ASCAP members generally use.)

This contractual device has several restraining features. It is an example of mutual agreement among ASCAP publishers not to clear performance rights at the same time the recording right is granted. Instead, the two are split. This coerces a broadcaster to obtain an ASCAP license if he wants the advertiser using the commercial to use his station. An advertising agency which places orders for time with broadcasting stations, by reason of the agreements, cannot and will not buy time from a station which does not have an ASCAP license.

A dramatic example of this coercion came to the appellant's attention after the trial. Attached hereto in Appendix "I" is a letter from McCann-Erickson, Inc., the agency handling the Humble Oil & Refining Company account, refusing to place an order with a Washington radio station unless it has an ASCAP license. (Letter dated February 14, 1962, from McCann-Erickson, Inc., to Radio Station KWYZ.) The same refusal was also sent to one of the defendants after the trial date. (See Appendix "I".) (Error for refusal to admit.)

The above contractual restraints are illegal under the Sherman Act. As previously stated, this practice of splitting performance rights and recording rights was struck down in the film industry. In both the *Witmark* and *Alden-Rochelle* cases the courts condemned the practice of movie producers requiring exhibitors to have ASCAP licenses before they could show films.

In entering a judgment against the ASCAP members, the court suggested the following solution:

> "Undoubtedly, the simplest plan for the copyright owners belonging to ASCAP would be for them to issue both synchronization rights and performance rights to the producers. This would provide a free competitive market in the motion picture industry for all copyright owners of music suitable for use in sound films. That the cost of the performance license would be passed on to the theatre owner is entirely probable, but plaintiffs would not be using their copyright privilege contrary to the public interest." *M. Witmark & Sons v. Jensen*, 80 F.Supp. at 850.

As a result of this in the sequel *Alden-Rochelle* decision Judge Leibell put the following in his decree:

> ". . . Plaintiffs are entitled to injunctive relief under title 15 U.S.C. § 26 (15 U.S.C.A. § 26), as follows:
>
> "(e) Restraining ASCAP and its members from conspiring with motion picture producers for the purpose of including a clause in contracts issued by producers to exhibitors directly or indirectly requiring exhibitors to obtain a license from ASCAP as a condition to the exhibition of licensed pictures." *Alden-Rochelle, Inc., v. ASCAP*, 80 F.Supp. at 902.[22]

22. The decree as amended compelled ASCAP to issue to motion picture *producers* licenses for performance rights so that the films could be exhibited by the theatre *exhibitors* anywhere in the United States without obtaining a separate license (Para. V (C) of the consent decree of 1950. Def. Ex. A-2). Thus, movie exhibitors today do not need licenses from ASCAP for performance rights. They are cleared "at the source"—through the producers. The exhibitors ultimately pay for the performance rights in the cost of the film.

Similar to the Washington Copyright Protection Act, the consent decree orders ASCAP to issue licenses for performance for profit to film producers—at the source—"on a 'per film' basis." (Para. V (C) (3) of the 1950 consent decree. Def. Ex. A-2). In addition, the negotiations on a "per film basis" are expressly forbidden from being negotiated on an "industry-wide" basis (Para. IV (C) (3) of the 1950 consent decree. Def. Ex. A-2).

The broadcasting industry, it is interesting to note, demanded clearance at the source in the *Shenandoah* case, *supra*. The demand was made that the consent decree required ASCAP to clear films for tele-

ASCAP members also are guilty of giving those who request performance rights with recordings the "run-around" as the practice was characterized by Justice Goldberg in the *Loew's* case decided in 1962, and *Zenith Radio* decided in 1965. For example, Mr. Starr testified that when his publishing companies were asked to clear music performing rights in a pre-recorded program for later broadcast that if the potential licensee

> ". . . insisted upon being given a price, he could not afford this price, plus the various terms that [they] would have to tie in with the price." (Def. Ex. A-31(a) Deposition of Herman Starr, pp. 58-59.)

Appellees make it impossible for users to get clearance the source by the old shell game.

The Effect of Competition

As shown previously, prices for musical copyrights in the ASCAP pool are fixed and stabilized because: (1) The ASCAP Board of Directors initially determines the fee and the terms of the license (R. 30, Fact 24, p. 6) (Def. Ex. A-31(g), p. 13); (2) Only one basic type of license is offered or required to be offered (R. 30, Facts 22, 28, 43, 44, pp. 5, 6, 9); (3) The form of license permits only one method of assessing fees—a percentage of gross revenues plus a flat sustaining fee (R. 30, Fact 23, p. 5, and Def. Ex. A-9); (4) ASCAP music is licensed only on a bulk basis and there is only one price for all music, regardless of its quality.

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vision use as well as theatre use. ASCAP opposed it on the ground that the broadcasters were not a party to the consent decree and have no standing to make the request. The Supreme Court of the United States upheld ASCAP, and held that only ASCAP itself, or the United States, the two parties to the decree, can intervene in the terms of the consent decree. See *Sam Fox Publishing Co. v. United States*, 366 U. S. 683 (1961).

The results of this artificial method of assessing fees are that on every dollar a broadcaster receives from the sale of his time, the copyright holder takes his tribute. No single copyright holder has the muscle to force a music user to pay on gross. It is only by placing the control of a vast number of copyrights in a performance rights society that the copyright holders have the power.

Let there be no mistake, the power still exists. This was eloquently demonstrated in 1959 when ASCAP brought the broadcasters to their knees by refusing to issue *any* licenses in the State of Washington. This fact is stipulated in the Pretrial Order:

> "In 1959 ASCAP *refused* to offer licenses to any broadcasters located in the State of Washington. (No. 30, Fact 73, p. 13) (Emphasis added.)

The appellees are ignoring the fact that music is not the only ingredient making up a broadcaster's product. The broadcaster sells an intangible complex composed of his announcers' voices, his disc jockeys' talent, and his news staff's efficiency (Tr. 269). A broadcaster takes great pains to see that his over-all station programming has a certain sound (Tr. 171) or style to compete against other stations seeking advertising revenues. The program sold to the time buyer is a complex, imaginative composite.[23] (Tr. 210, 305). No announcer can force a broadcaster to pay him tribute by requiring a percentage of gross

23. The testimony of Mr. James W. Wallace, President of KPQ, is pertinent:

> "I know exactly what music we play. We have a list of it.
>
> "As to how I arrive at knowing what the music should be, I should give you a background (here the witness lists his qualifications to know his community) . . . and these things are all necessary for a small-town radio station man to know what the people want.
>
> "For one thing, almost 60 per cent of our income comes from sources other than music . . . but still we are obligated under any

sales. No newscaster or sportscaster can. No sales manager can successfully demand "To have my services you must pay me a percentage of your gross." Only the music composer can exact such tribute and pirate management's imagination, the disc jockey's personality, the newsman's skill and the sales manager's ideas.

Furthermore, this point is clear. Every witness called by the defendants testified he could not successfully operate his station without the music controlled by ASCAP (Tr. 165, 205, 246, 273, 314). Appellees offered no evidence otherwise.

Once a broadcaster has a blanket license encompassing over a million copyrights, only a minute percentage of which he can possibly use, he has no incentive to deal with individual composers. Thus, unknown individual songwriters are effectively screened from the market. Those composers not members of ASCAP have no means of selling their songs to broadcasters, the most important means for popularizing music (Tr. 24, 25, 26, 169, 317-319).

But for ASCAP's existence, the individual copyright owner would be required to find another and lawful method to market his music and to do so he would have

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contract offered us by ASCAP to pay on the total amount and not on that portion of the music used." (Tr. 210-211).

One witness testified that on his station only 44 per cent of the station's revenues come from programs where music is involved (Tr. 225). He further stated:

"Our principal revenue comes from news, sports, politics and programs and announcements that pay a premium rate to be adjacent to news." (Tr. 226).

Furthermore, it was stipulated that broadcasters must offer diverse programming. If they broadcast only music, the Federal Communications Commission could question their right to operate (Tr. 16-17).

to price it also.[24] The free play of competition would provide a solution as happened when Judge Leibell freed motion picture exhibitors from ASCAP's restrictive practices and required licensing at the source. The same solution would come if recordings were cleared at the source.

As previously pointed out, stipulation and testimony in the trial established that composers are anxious to have stations play their music, but there is no individual bargaining or negotiating between broadcasters and composers (Tr. 24, 25, 26, 169). Herman Starr, president of Music Publishers' Holding Corporation, the holding company owning 100% of the stock of several of the appellees herein and a member of the Board of Directors of ASCAP for 25 years, testified not only is there no competition among the ASCAP members, but, indeed, their employees are forbidden to talk price because ASCAP is the only one allowed to do so.

"Q. Will you answer the question, please?

"A. They have nothing to do with price.

"Q. That is fixed by the ASCAP license, isn't it?

"A. Yes, it is not within their scope to talk price. These are people who go out to exploit music. They are not salesmen." (Def. Ex. A-312, Dep. of Herman Starr, pp. 60-62)

Appellees and the trial court relied heavily upon the

24. Testimony of Mr. Lincoln Miller, Assistant President, KIRO AM-FM-TV:

"We try to adjust what we call the sound because it is different from other stations so we might want to play all western or all religious, so in the case of our station (KIRO, Seattle) we try to balance with a little bit of everything, but if we knew what the price tags were, this could well influence the kind of music we play and balance with the kind of music we play. It would certainly influence our decision because the economics would be right in front of us. We would be free to determine." (Tr. 171, 172).

stipulated fact that it would be commercially impossible for broadcasters to negotiate with each individual copyright owner for each composition played (No. 30, Fact 56, p. 10; No. 37, Fact 25, p 37; No. 25, Memo. Opinion, pp. 5-6). Yet, appellees offered no evidence that other marketing methods such as clearance at the source on records are impossible or for that matter impractical. Broadcasters testified that if records were marked and the performing rights cleared with the recording rights, it would be a simple matter for them to operate and pay performance rights fees with the purchase of records, and they would welcome the opportunity to do so. (See Appendix "H" at pp. 284, 306 for text of testimony.) Music received from networks is cleared at the source, as is background music and music on motion picture films (No. 30, Fact 59, p. 11). This demonstrates that licensing at the source is workable if only given a chance.[25]

Although the trial court apparently chose to ignore it, several experienced broadcasters testified that licenses using a fee schedule based upon per piece rates would be workable so long as price lists were available (Tr. 170-171, 210-211, 266, 268-269, 284, 303-307). (See text in Appendix "H.")

Monopolization—Violation of Section 2

The appellant next calls the court's attention to appellees' violation of Section 2 of the Sherman Act. Testimony shows that ASCAP controls almost all the copy-

25. That this licensing at the source works is shown by European practice of having the recording company licensee pay fees to the copyright owner in ratio of the sales of the copyright owner's records to the total sales of records by the recording company. Shemel and Krasilovsky, *The Business of Music*, 22 (1964).

righted show tunes in the country. Show tunes or popular standards, the uncontroverted testimony shows, are the bread and butter of the defendants' programming. Without them defendants will die. Thus ASCAP has effectively monopolized the show tune market, not to mention the general performance rights market. The act of monopolization is condemned by Section 2. See *American Tobacco Co. v. United States,* 328 U.S. 781 (1946); *United States v. Aluminum Co. of America,* 148 F.2d 416 (2d Cir. 1945); *United States v. United Shoe Mach. Corp.,* 110 F.Supp. 295 (D. Mass. 1953), Aff'd, 347 U.S. 521 (1954).

Section 2 requires the courts to move against two acts, namely, an attempt by a single person (ASCAP) and conspiracies by two or more persons (the members) to monopolize. More than 50% of all performances of copyrighted music—not just show tunes—by broadcasting stations in the United States are licensed by ASCAP and are performances of compositions in which the copyrights are held by members of ASCAP (R. 37, Fact 18, p. 5). Therefore, ASCAP has violated Section 2 by its monopolization of music licenses and its members have violated the section by conspiring to monopolize. *Hazeltine Research, Inc., v. Zenith Radio Corp.,* 239 F.Supp. 51 (1965).

Misuse of the Copyright Privilege Constitutes a Defense to Infringement Actions

(Specification of Errors 23, 25, 26, 29, 30, 35, 36, 37, 40, 41, 42, 44, 45, 47, 51)

Appellees contend that appellant's violations of the Washington law and the federal antitrust laws are not

defenses to infringement suits; appellant contends that they are.

Appellees' contention is based upon two grounds—federal supremacy and that the doctrine of unclean hands is inapplicable.

The Effect of Violation of State Statutes

As previously shown, the United States Supreme Court held that states have the power to regulate combinations of copyright owners notwithstanding the fact that copyrights flow from federal power. Federal bestowal of privileges does not mean federal bestowal of immunity from state law or bestowal of the right to misuse a privilege.

The Supreme Court said that statutes like Washington's were "... aimed at the power exercised by combinations of copyright owners over the use of musical compositions for profit." *Buck v. Gallagher*, 307 U.S. at 99. The court, in dealing with the question of supremacy of federal copyright laws over the state laws, held in a case involving a Florida statute like Washington's:

> "We find nothing in the copyright laws which purports to grant to copyright owners the privilege of combining in violation of otherwise valid state or federal laws . . ." *Watson v. Buck*, 313 U.S. at 404.
>
> "It is enough for us to say in this case that the phase of Florida's law prohibiting activities of those unlawful combinations described in Sec. 1 of the 1937 Act does not contravene the copyright laws or the federal constitution . . ." *Id.* at 405.

This disposes of the appellees' contention of federal supremacy and that the Washington law is unconstitutional.

Appellees urge that appellants, by resorting to the state statute as a defense, seek to deprive the appellees of their rights. The Washington Act does not prohibit the bringing of federal suits for infringement. The act only provides the copyright holders who choose to pool their interests and do business in Washington must license on a per piece basis in accordance with Washington laws. The Supreme Court suggests a course for those who complain about losing their patent rights to infringers:

> "Equity may rightly withhold its assistance from such a use of the patent by declining to entertain a suit for infringement, and should do so at least until it is made to appear that the improper practice has been abandoned." *Morton Salt Co. v. G. S. Suppiger Co.*, 314 U.S. 488, 493 (1942).

Whether the Washington legislature's prohibitions against pooling, and issuing blanket licenses and requiring per piece licenses is considered by appellees or the District Court as workable, practicable, or fair is beside the point. (See Argument, *supra.*) It is not the prerogative of the music peddlers to tell the Washington legislature or Washington courts what is right, just, fair or reasonable. The copyright holders and the trial court are mistaken if they expect their subjective opinions of what is fair to supersede the Washington lawmakers' determinations.

The same can be said for the trial court's opinion that individual licensing is impossible because this would hinder the copyright owners in policing their rights and increase the cost of their administration (R. 35, 37, Fact 25, p. 5). The United States Supreme Court settled this by the doctrine that expediency is no excuse. (See Argument, *supra,* and several cases previously cited.) The

following pronouncement clearly shows the error in the trial court's reasoning:

> "Nor is it within our province in determining whether or not this phase of the state statute comes into collision with the Federal Constitution or laws passed pursuant thereto, to scrutinize the act in order to determine whether we believe it to be fair or unfair, conducive to good or evil for the people of Florida, or capable of protecting or defeating the public interest of the state. These questions were for the legislature of Florida and it has decided them." *Watson v. Buck*, 313 U.S. at 403.

In *Leo Feist v. Young*, 138 F.2d 972 (7th Cir. 1943), a Wisconsin statute was urged as a defense to copyright infringement suits. The court held that violation of the statutes would not constitute a defense because the Wisconsin statute was a licensing statute ". . . not relevant or material to the issue presented by the complaint." *Leo Feist v. Young*, 138 F.2d at 976.

The Wisconsin statute did not involve the same public interest considerations as the Washington Act. It was not an antitrust statute as is Washington's. Furthermore, and very significantly, the Wisconsin statute did not make it is a crime for a user of music to deal with the plaintiffs.[26]

The *Feist* court stated that, had the Wisconsin statute been one protecting the public interest, as are the Washington statute and the federal antitrust laws, then the public interest must prevail over the interests of individual copyright holders:

> "In reaching our conclusion we have not overlooked the fact that the Supreme Court has recently

26. In Washington, RCW 19.24.100 and RCW 19.24.290 make it a criminal offense punishable by fine and imprisonment for anyone to sign blanket licenses or to deal with any violator of the act. The Wisconsin statute has no counterpart.

stated that courts of equity may appropriately withhold their aid where the plaintiff is using the right asserted contrary to the public interest. *Morton Salt Co. v. Suppiger*, 314 U.S. 488, 492, 62 S. Ct. 402, 86 L.Ed. 363, or many cases which hold that equity will not aid a law violator, or the fact that the maxim is applied, not to favor a defendant, but because of the interest of the public. But in most of these authorities the plaintiff was seeking to extend the scope of his lawful patent monopoly beyond the scope of the grant or was seeking equity's aid against the very statute which he had violated. Thus the illegal action, which warranted the application of the clean hands doctrine to preclude relief, was inextricably intermingled and connected with the cause of action or at least directly related to it, whereas here the violation of the Wisconsin statute was collateral to the cause of action and certainly not directly related to it." *Leo Feist v. Young*, 138 F.2d at 976.

Appellees' misconduct is related to the appellant's, inextricably intermingled and connected to the causes of action for infringements, and directly connected with the issues being litigated.

ASCAP and its members are violating the Washington Act by issuing blanket licenses. The very activities which the act condemns are the very reasons why the appellant is placed in the position of infringing. If the appellees were not violating the act, namely, issuing blanket licenses, the appellant could lawfully do business with them. It was clearly established by the testimony that stations must have ASCAP music to operate and stay in business. Appellant and all users of music in Washington are on the horns of a dilemma. If they are forced to take ASCAP's illegal blanket licenses, they will be violating Washington law. If they play music without an

ASCAP license, they will be sued for infringement. Although appellant must have ASCAP music to stay in business, there is no lawful or practical means offered to it to have the music.[27]

Their only alternative, therefore, is to close their stations and go out of business:

> "The injury to Zenith's business was occasioned by the necessity that defendant make a choice among alternatives each of which had an adverse economic effect on its business. It was forced either to cease manufacturing and selling its television receivers, pay tribute with consequent increase in its costs or incur the expenses incident to the defense of protracted patent litigation. Although defendant's choice determined the nature and amount of the resulting damages, it was the necessity of having to choose that occasioned injury." *Hazeltine Research, Inc. v. Zenith Radio Corporation,* 239 F.Supp. at 72.

The Effect of Misusing Copyrights

In ruling that misuse of copyrights and patents renders the right granted unenforceable, the courts are applying old and tested equity principles. It does not matter really whether the abuses flow from violations of specific statutes such as federal antitrust laws. The principles applied are principles of basic fairness. One should not be allowed to forge a privilege beneficently bestowed into a tool to exploit others and foster one's own schemes in derogation of the rights of others. When patents or copyrights are being used to foster monopoly, rather than reward incentive and provide for the public good, courts invariably refuse their aid:

"An illegal combination of copyrights and a pool-

27. It has been stipulated that it is impractical for defendants to deal with the thousands of individual copyright owners.

> ing of the proceeds derived from the licensing of the copyrights through the illegal combination, renders unenforceable the rights granted under the Copyright Act, at least while the illegal combination continues. See *Morton Salt Co. v. G. S. Suppiger Co.*, 314 U.S. 488, 62 S.Ct. 402, 86 L.Ed. 363; *B. B. Chemical Co. v. Ellis*, 314 U.S. 495, 62 S.Ct. 406, 86 L.Ed. 367, and *United States v. Line Material Co.*, 333 U.S. 287, at Page 310, 68 S.Ct. 550. . . ." *Alden-Rochelle, Inc. v.* ASCAP, 80 F.Supp. at 904.

The *Witmark* case is indistinguishable from the present case. The court could not have been more specific in clearly holding that unclean hands and abuse of copyright laws are defenses to infringement actions.

> "One who unlawfully exceeds his copyright monopoly and violates the antitrust laws is not outside the pale of the law, but where the Court's aid is requested, as noted herein, and the granting thereof would tend to serve the plaintiffs in their plan and scheme with other members of ASCAP to extend their copyrights in a monopolistic control beyond their proper scope, it should be denied." *M. Witmark & Sons v. Jensen*, 80 F.Supp. at 850.

A leading case is the *Mercoid* case which unequivocally teaches that patent abuses are a defense to an infringement action:

> "In those cases both direct and contributory infringement suits were disallowed on a showing that the owner of the patent was using it 'as the effective means of restraining competition with its sale of an unpatented article.'" *Mercoid Corporation v. Mid-Continent Investment Co.*, 320 U.S. 661, 665 (1944).
>
> "It is sufficient to say that in whatever posture the issue may be tendered courts of equity will withhold relief where the patentee and those claiming under him are using the patent privilege contrary to the public interest." *Id.* at 669.

To the same effect see *International Salt Co., Inc. v. United States,* 332 U.S. 392, 401 (1947):

> "In an equity suit, the end to be served is not punishment of transgression, nor is it merely to end specific illegal practices. A public interest served by such civil suits is that they effectively pry open to competition a market that has been closed by defendants' illegal restraints."

The same principles are applicable to copyright actions as they are to actions involving patents:

> "Since one of the objectives of the patent laws is to reward uniqueness, the principle of these cases was carried over into antitrust law on the theory that the existence of a valid patent on the tying product, without more establishes a distinctiveness sufficient to conclude that any tying arrangement involving the patented product would have anti-competitive consequences. E.g., *International Salt Co. v. United States,* 332 U.S. 392. In *United States v. Paramount Pictures, Inc.,* 334 U.S. 131, 156-159, the principle of the patent cases was applied to copyrighted feature films which had been block booked into movie theaters." *United States v. Loew's, Inc.,* 371 U.S. at 46.

The case of *Kobe, Inc. v. Dempsey Pump Co.,* 198 F.2d 416 (10th Cir. 1952) cert. denied 344 U.S. 837 (1952), is very much in point. In this case the plaintiff in an infringement suit was found to have monopolized the rodless oil pump industry by buying up all present and future patents in the field and extracting covenants not to compete from sellers. (Much like ASCAP has "bought" all the performance rights of its members and extracted covenants they will not license through anyone else (R. 30, Fact 68, p. 12), and with the understanding they will not compete). In affirming the trial court's treble damage judgment in favor of the defendant and its refusal to

grant relief to the plaintiff because of patent misuse, the court stated, per Pickett, C. J.:

> "It is said that to allow recovery of the damages resulting from the infringement action would be a denial of free access to the courts. We fully recognize that free and unrestricted access to the courts should not be denied or imperiled in any manner. At the same time we must not permit the courts to be a vehicle for maintaining and carrying out an unlawful monopoly which has for its purpose the elimination and prevention of competition." *Kobe Inc. v. Dempsey Pump Co.*, 198 F.2d at 424.

Again in the recent *Zenith Radio* case, the court granted the defendant a defense to infringement suits and allowed counterclaimed damages of several million dollars where it was shown the plaintiff had misused its patents and violated the antitrust laws. Relief and damages were awarded on the traditional grounds that the plaintiff came into ". . . court with unclean hands and is therefore barred from receiving any relief. . . ." *Hazeltine Research, Inc. v. Zenith Radio Corporation*, 239 F. Supp. 51, 69 (1965).

There is another factor that should be called to the court's attention. It is not necessary for the appellant to show that the appellees have violated the antitrust laws for the court to grant appellant a defense. This distinction can be seen in studying differences between the *Mercoid* and the *Morton Salt* cases.

In *Mercoid* the Supreme Court expressed the mandate that one who misuses his patent privilege in violation of the antitrust laws must by the nature of his abuse of the patent privilege lose his right to protect that privilege by suit. Whereas in *Morton Salt*, there was no finding

that the patentee had violated the antitrust laws. Nevertheless the court held:

> "It is unnecessary to decide whether respondent has violated the Clayton Act, for we conclude that in any event the maintenance of the present suit to restrain petitioner's manufacture or sale of the alleged infringing machines is contrary to public policy and that the district court rightly dismissed the complaint for want of equity." *Morton Salt Co. v. Suppiger,* 314 U.S. at 494. (See the discussion of these cases in Kintner, *An Antitrust Primer,* 86-87 (1964).

The Relative Culpability of the Parties

Specification of Errors 3, 5, 6, 7, 13, 14, 21, 22

Without citing any authority, the appellees, during the trial and by memoranda, urged that although the activities of the copyright holders may have been less than lawful, the real culprits were the broadcasters. The trial court apparently accepted this argument. It ruled in its written opinion that notwithstanding the appellees may have been guilty of violating state or federal antitrust laws, their violations were minimal compared with the defendants' conduct (R. 35, Mem. Opin. p. 6; R. 37, Concl. 19, p. 24). The court's decision was made without citing a single case for its position. Whereas, appellant in its Post-Trial Memorandum (R. 33) cited much authority contrary to the appellees' assertion and the trial court's apparent decision.[28]

Appellant has been unable to find any authority for the court's determination that copyright infringement is more

28. It is interesting to note that the appellant, by written memorandum, cited many cases showing that conduct like that of the ASCAP and its members was violative of the anti-trust laws and such abuses were defenses to infringement actions. The appellees in their memoranda cited no cases to the contrary, and the court cited none in its opinion. Yet, the trial court still found against the appellant on these issues.

blameworthy than copyright abuse and, therefore, the infringer must give ground to the abuser. On the contrary, all the cases cited above by the appellant are just the opposite.

The only assumption appellant can make is that the trial court made a subjective determination all on its own. Appellant is almost helpless to argue the matter because the trial court was silent in its opinion on both legal grounds and on its personal convictions for the determination. It would appear from lack of information that the decision was almost capricious and arbitrary.

In any event, the court's weighing of the relative culpability of the parties before determining whether the appellees' misconduct is a defense is in error. The courts do not agree with the trial court on this point. There has been no deviation in the decisions from the traditional concept recently enunciated by the Supreme Court:

> "This principle grew out of a long line of patent cases which had eventuated in the doctrine that a patentee who utilized tying arrangements would be denied all relief against infringements of his patent." (Citations omitted.) *United States v. Loew's, Inc.* 371 U.S. at 46.

The doctrine that abuses of copyright or patent privileges is a defense to an infringement suit could only have arisen after infringement had taken place. Without infringement, the principle would never have evolved.

The *Witmark* case was an infringement case, and the court said:

> "One who unlawfully exceeds his copyright monopoly and violates the antitrust laws is not outside the pale of the law, but where the Court's aid is

> requested, as noted herein, and the granting thereof would tend to serve the plaintiffs in their plan and scheme with other members of ASCAP to extend their copyrights in a monopolistic control beyond their proper scope, it should be denied." *M. Witmark & Sons v. Jensen*, 80 F.Supp. at 850.

The infringer's wrongdoing was recognized in the landmark *Mercoid* case by the Supreme Court:

> "And we may assume that *Mercoid* did not act innocently." *Mercoid Corporation v. Mid-Continent Investment Co.*, 320 U.S. 661, 664 (1944).

Justice Jackson stated in the case:

> "It is suggested that such a patent should protect the patentee at least against one who knowingly and intentionally builds a device for use in the combination and vends it for that purpose. That is what appears to have been done here. As to ethics, the parties seem to me as much on a parity as the pot and the kettle . . . The less legal rights depend on someone's state of mind, the better." *Id.* at 679-680.

Of course, much of this is beside the point, as is appellees' attempt to excuse their own illegal conduct by calling the defendants more blameworthy. The appellees and the trial court confuse the relative conduct of the parties with the substantive reason for denying the copyright holder relief. The paramount policy is the protection of the public against abuses of the copyright monopoly and from enabling copyright owners to ". . . carve out exceptions to the antitrust laws which Congress has not sanctioned." *Mercoid Corporation v. Mid-Continent Investment Co.*, 320 U.S. at 667.

> "It is the public interest which is dominant in the patent system . . . It is the protection of the public in a system of free enterprise which alike nullifies a

patent where any part of it is invalid . . . and denies to the patentee after issuance the power to use it in such a way as to acquire a monopoly which is not plainly within the terms of the grant." *Id.* at 665-666.

Again the Supreme Court lays out the rule:

"It is the adverse effect upon the public interest of a successful infringement suit in conjunction with the patentee's course of conduct which disqualified him to maintain the suit, regardless of whether the particular defendant has suffered from the misuse of the patent . . . The patentee, like these other holders of an exclusive privilege granted in the furtherance of a public policy, may not claim protection of this grant by the courts where it is being used to subvert that policy." *Morton Salt Co. v. Suppiger,* 314 U.S. 488, 494 (1944).

"Maintenance and enlargement of the attempted monopoly of the unpatented article are dependent to some extent upon persuading the public of the validity of the patent, which the infringement suit is intended to establish. Equity may rightly withhold its assistance from such a use of the patent by declining to entertain a suit for infringement, and should do so at least until it is made to appear that the improper practice has been abandoned and that the consequences of the misuse of the patent have been dissipated." *Id.* at 493.

As a most recent writer puts it:

"The doctrine of misuse is grounded on a 'public policy' and may operate on equitable grounds to deny relief in a private suit for patent infringement." Kintner at 86.

Another point that the Supreme Court is making is that those injured by abuses of patents or copyrights should not be less protected by the antitrust laws than those injured by other violations. The antitrust laws were enacted by Congress to afford individuals like the broadcasters

protection against just such combined abuses as these appellees and the other members of ASCAP are practicing. Indeed, the broadcasters testified that they have stood ready and willing to deal with the appellees and pay for performing rights if they just had the simple right to bargain as they do for other raw materials going into their product, or if they had the right to purchase performing rights with the purchase of records as the movie producers have. (See testimony in Appendix "H.")

If these appellees and the other members of ASCAP had not in the first instance combined their individual copyrights to gain tremendous economic power through control of over a million copyrights, the appellant would not be in court today, and would not be facing the bleak alternatives of breaking the law or quitting business. The appellees by the nature of their infringement actions are the first to ask this court for equitable relief. Were the injunction to be granted, equity would not only be aiding a lawbreaker, but would also coerce appellant to either violate the law or to forsake his enterprise:

> "Respondents ask the equity court for an injunction against infringement by petitioner of the patent in question and for an accounting. Should such a decree be entered, the court would be placing its imprimatur on a scheme which involves a misuse of the patent privilege and a violation of the antitrust laws. It would aid in the consummation of a conspiracy to expand a patent beyond its legitimate scope." *Mercoid v. Mid-Continent Invest. Co.*, 320 U.S. at 670.

Again we see that public interest considerations are paramount and not the relative interest of private litigates or the relative nature of their deeds. (See also the *Zenith Radio* case, *supra,* where the infringer deliberately re-

fused a bulk license and several alternative licenses and the court correctly held for the infringer and against the patent holder.)

As previously noted the trial court's Findings of Fact and Conclusions of Law are given little weight in this type of proceeding. It is so fundamental as not to need citation that the trial court's Findings of Fact must be based on evidence to support it unless stipulated. 5 MOORE'S FEDERAL PRACTICE 2609. There is not one word in the entire record relating to appellant, K-91, Inc., being in any way more culpable. Although the president of appellant, Mr. Nelskog, was present in court during the entire trial, appellees chose not to call him as a witness, nor anyone else from K-91, Inc. Although Rogan Jones was cross-examined concerning his refusal to license under ASCAP's methods, that is completely immaterial to this particular appellant. Mr. Jones was hardly the agent for K-91, Inc. These cases were separate cases consolidated for trial. The only evidence regarding K-91, Inc.'s refusal to license was stipulated:

> "MR. RONALD MURPHY: Mr. Jones and Mr. Nelskog and Mr. Wallace would testify for their stations that if the contracts which plaintiffs offer through ASCAP and by ASCAP were legal in this state and were legal under federal law, they would be prepared to do business with them and would sign the contracts.
>
> "THE COURT: They will stipulate that they would so testify.
>
> "MR. TOPKIS: We want to cross-examine a little bit on that, Your Honor.
>
> "THE COURT: Very well." (Tr. 30)

No such cross-examination ever took place concerning appellant. The entire record as far as this appellant is

concerned is that it was willing to license if the licenses were legal (Cf. *Zenith Radio* case, 239 F.Supp. 51 (1965)).

Yet the trial court found appellant failed to take a license only to avoid paying license fees. Specification of Error 3. There was no evidence to this effect.

The trial court also found appellant broadcast appellees' compositions for ten years on a regular basis. Specification of Error 6. There is no evidence to this effect. There is no evidence that K-91, Inc. was even in existence for ten years.

Again, there was no evidence as the court found in appellant's Specification of Error 14 that K-91, Inc. failed to take a license only because it wanted to avoid paying license fees. Not only does the only evidence demonstrate K-91, Inc. would license if the licenses were legal, but in fact the defendants did pay fees that went to the appellees through networks (R. 30, Pre-Trial Order, Admissions Nos. 1 and 2; Tr. 248).

Again, the trial court found that K-91, Inc., which has not been in existence for ten years, committed numerous other infringements of plaintiffs' copyrighted compositions during the last ten years. Specification of Error 22.

In short, this case was tried primarily on the issue of appellees' conduct. The trial court recognized at least "minimal" violations of the federal antitrust laws on the part of the appellees (R. 35, Mem. Op., p. 6), but then found all defendants to have been the real culprits. There was not one word in the entire record that K-91, Inc. did anything even suggesting it more blameworthy, or that it even existed for ten years—which it didn't. As previously set forth, the cases demonstrate that in patent

and copyright infringement cases the issue isn't whether or not the defendant infringed. *That is always conceded.* The issue is whether the plaintiff has so abused his copyrights as to preclude recovery from the infringer who has in *all of these cases* refused to be a party to an illegal arrangement and taken the only available alternative—infringement.

The Effect of the Consent Decree

Specification of Errors 43, 46 and 47

We have discussed the pertinent cases at length herein and will not repeat them except in the briefest manner. For instance, we have already seen that the consent decree was in effect at the time of the *Alden-Rochelle* and *Witmark* cases. In both cases, the courts gave due recognition to the fact that ASCAP and its members were subject to a consent decree and that the performance rights assigned to ASCAP were granted on a non-exclusive basis because of the consent decree. Both courts still found ASCAP's members in violation of the antitrust laws. The court in *Alden-Rochelle* issued injunctions that went far beyond the boundaries of the consent decree.

Appellant readily admits that the consent decree is of considerable importance to this litigation—but only because it affects the activities of ASCAP. The mere fact that it is court-approved does not make it binding on anyone other than the parties to the decree, which are the United States and ASCAP.

It has been stipulated that no broadcaster, including appellant herein, was a party to the action brought by the United States against ASCAP that terminated in the consent decree (R. 30, Fact 51, p. 10). Nor were any of

the defendants, including appellant, consulted by the United States concerning said action and decree (R. 30, Fact 52, p. 10). Obviously, appellant was not consulted by ASCAP or a representative of ASCAP (R. 30, Fact 53, p. 10).

Not even the ASCAP members themselves can intervene in the terms of the consent decree. The *Fox Publishing* case flatly ruled this to be the case when one of ASCAP's disenchanted members attempted to have his say about the terms of the consent decree.

> "We regard it as fully settled that a person whose private interests coincide with the public interest in government antitrust litigation is nonetheless not bound by the eventuality of such litigation, and hence may not, as of right, intervene in it. In *United States v. Borden Co.*, 347 U.S. 514, 98 L.Ed. 903, 74 S.Ct. 703, it was ruled that it was an abuse of discretion for the District Court to refuse the Government an injunction against certain acts held violative of the antitrust laws, even though the same acts had already been enjoined in a private suit. It was there stated in the clearest terms that 'private and public actions were designed to be cumulative, not mutually exclusive' (*Id.* 347 U.S. at 518), and, quoting from *United States v. Bendix Home Appliances, Inc.* (D.C., N.Y.) 10 F.R.D. 73, 77 '... The scheme of the statute is sharply to distinguish between Government suits, either criminal or civil, and private suits for injunctive relief or for treble damages. Different policy considerations govern each of these. They may proceed simultaneously or in disregard of each other.' [Citation omitted.]
>
> "This principle is certainly broad enough to make it clear that just as the Government is not bound by private antitrust litigation to which it is a stranger, so private parties, similarly situated, are not bound by government litigation." [Citations omitted.] *Sam Fox Publishing Co. v. United States*, 366 U.S. at 689, 690.

When the broadcasters requested clearance at the source like that enjoyed by movie exhibitors under the terms of the consent decree in the *Shenandoah* proceedings, Judge Ryan held that since they were not parties to the decree they could not seek to modify it and had nothing to say about it:

> "Petitioners were not parties to the judgment; they have petitioned only as beneficiaries under it and they may not under cover of the protection from discrimination afforded them under its provisions indirectly effect an amendment to that judgment so as to wrest from ASCAP a type of license it is now under no judicial compulsion to grant." *In the Matter of the Application of Shenandoah Valley Broadcasting Inc.* et al., Petitioners, For the Determination of Reasonable License Fees, United States District Court, Southern District of New York, Civil 13-95.

The illegal conduct of ASCAP and its members has gone unheeded since the rulings of Judge Nordbye in the *Witmark* decision. Just as the 1941 decree did not excuse ASCAP's unlawful activities in 1950, the 1950 decree does not excuse such conduct in 1965, nor does it curtail the rights of third persons to challenge the unlawful activities.

> ". . . the antitrust consent decree is not to be viewed solely as a contract resulting from an unrestricted bargaining process between the government and the defendants. Rather, it is an agreement for a voluntary settlement of antitrust issues in which the scope and content of the provisions therein can rise no higher than their source in the legislative objectives and prohibitions of the standards embodied by Congress in its national antitrust policy . . . It follows, therefore, that neither antitrust officials nor a court of equity has authority under law to induce or accept provisions in consent decrees unless they are related to the prevention or correction of violations of the antitrust laws within the congressional objectives of

that legislation. . . ." Oppenheim, Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy, 50 Mich. L.Rev. 1139 at 1230, 1234 (1952).

Price fixing under a consent decree is still price fixing by any other name. Monopolization under a consent decree is still monopolization. Pooling copyrights and sharing fees under a decree are still activities and agreements in restraint of trade. No decree can cut-off or curtail the rights of third parties under Section 4 of the Clayton Act (15 U.S.C.A. §15).

As the *Fox Publishing* case pointed out, private litigants are not bound by the acts of Government to which they are strangers. Nor can the Department of Justice bind the legislature of the State of Washington. Although the present arrangements found in the consent decree may satisfy state and federal law enforcement officials and the trial court, that does not mean they satisfy the laws passed by the Washington State Legislature, or by Congress.

The Justice Department may determine when and how to act to protect the public, but the Justice Department is not infallible by any means—witness the difference in the 1941 decree and the 1950 decree—and the department certainly does not have the power to determine when and how private parties may assert their rights under Section 4 of the Clayton Act.

The Second Circuit recently had the opportunity to pass upon the application of the 1950 consent decree in *United States v. American Society of Composers, Authors and Publishers,* 331 F.2d 117 (2 Cir. 1964). In affirming Judge Ryan's ruling that broadcasters cannot intervene in the consent decree, that does not prevent them from

asserting their own rights in private antitrust litigation, such as this case is:

> "If appellants' position in fact has the merit under the antitrust laws which they assert, they have effective remedies available, either by persuading the Department of Justice to apply under Section XVII for a modification of the Judgment, *or by a private suit which our ruling here in no way affects.*" *United States v. American Society of Composers, Authors and Publishers,* at 124. (Emphasis added.)

The Power of the Court

More important than damages and attorneys' fees the appellant asks the court to issue injunctions. The specific requests are set forth in the pretrial order as "Defendants' Contentions of Law," No. 8 (R. 30, pp. 29-30), and in Appendix "E" of this brief.

Not only should the court follow the unswerving line of authorities and hold that appellees' activities render their performance rights unenforceable, but the court should compel remedial measures. Confronted with similar copyright misuse, the trial judge in *Alden-Rochelle, Inc. v. ASCAP, supra,* issued injunctions prohibiting continued wrongdoing. The court went to the heart of the problem in the second *Alden-Rochelle* opinion dealing with the decree. *Alden-Rochelle, Inc. v. ASCAP,* 80 F. Supp. 900 (1948). Quoting from the Supreme Court, Judge Leibell said:

> " 'If the alleged combination is shown to exist, the decree which can be entered will be no idle or futile gesture. * * * It will supply an effective remedy without which there can be only an endless effort to rectify the continuous injury inflicted by the unlawful combination. The threatened injury is clear.' " *Alden-Rochelle, Inc. v. ASCAP,* 80 F.Supp. at 903, quoting

Georgia v. Pennsylvania R.R., 324 U.S. at 462.

In *Bigelow v. RKO Radio Pictures*, 162 F.2d 520, at page 524, the Circuit Court of Appeals, Seventh Circuit, said:

> ". . . the decree may very properly be used to destroy the conspiracy root, branch, and all its evil fruits. . . ."

Thus, in *Alden-Rochelle*, Judge Leibell wrote a meaningful decree compelling ASCAP and its members to, among other remedies, license performing rights with motion picture recording rights, and actually prohibited ASCAP and its members from suing theater exhibitors for infringement of performance rights. There is no substantive difference between a musical recording and a motion picture recording, nor is there a substantive difference between a radio station's use of a record and a theater's use of a film. If there are, let the appellees come forth with their brief and show us.[29]

More authority for the courts' power to write far-reaching and effective decrees is cited below:

> "The generality of the standards of the antitrust laws creates a broad range of discretion with respect to the content of provisions incorporated in consent decrees. It is clear that provisions may go beyond the prohibition of conduct previously adjudged by the courts as antitrust violations and embrace relief that may be reasonably anticipated after litigation. As in other equity decrees, a consent decree may enjoin not only the precise transactions or conduct complained against but also activities subject to abuses

29. It is interesting to note that to this day television stations using the same films as moving picture theatres still must have ASCAP license to broadcast the films. Judge Leibell's decision did not include films used on television because television did not become an important factor until after 1948.

similar to those specified in the complaint." OPPENHEIM, FEDERAL ANTITRUST LAWS, p. 1065 (2d Ed. 1959).

* * * *

"'In the antitrust field the courts have been accorded, by common consent, an authority they have in no other branch of enacted law.'" VAN CISE, UNDERSTANDING THE ANTITRUST LAWS, p. 17 (1963).

This court has the power to pry from ASCAP the performance rights of over a million compositions and release them to users on a competitive basis; to reward those composers deserving of reward; and to free valuable music from subsidizing unused, unwanted and mediocre music. This court can and should compel compulsory licensing.

"Compulsory licensing and sale of patented devices are recognized remedies. They would seem particularly appropriate where, as here, a penchant for abuses of patent rights is demonstrated." *Besser Manufacturing Co. v. United States,* 343 U.S. 444, 449 (1952).

The court can even enjoin acts which would otherwise be permissible if it were not for the vast block booking arrangements perpetrated by ASCAP's members. This is the rule of the *Loew's* case in which film companies block booked copyrighted films. In the *Loew's* case the Supreme Court even added more to the injunctions demanded by the trial court.

"Some of the practices which the Government seeks to have enjoined with its requested modifications are acts which may be entirely proper when viewed alone. To ensure, however, that relief is effectual, otherwise permissible practices connected with the acts found to be illegal must sometimes be enjoined. (Citations omitted.) When the Government has won the lawsuit, it is entitled to win the cause as well." *United States v. Loew's, Inc.,* 371 U.S. at 53 (1962).

CONCLUSION

This has been a long and complicated lawsuit involving many facts and many issues. The appellant respectfully beseeches the court to cut away the chaff and go to the heart of the matter. This means the court should apply the established and traditional equitable principles laid down by the courts without deviation since the advent of patents and copyrights in this nation, and reverse the judgment, and grant the injunctive relief, attorneys' fees and costs sought by the appellant.

Respectfully submitted,

RONALD A. MURPHY
Attorney for Appellant
K-91, Inc.

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RONALD A. MURPHY
Attorney for Appellant

APPENDICES

APPENDIX "A"

Facts Stipulated in the Pretrial Order But Omitted from the Findings

(Specification of Error No. 18)

18-1. Although certain defendants did not pay royalties directly to ASCAP or the plaintiffs, they did pay royalties to plaintiffs by paying fees to networks which passed them on to plaintiffs. (R. 30, Agreed Fact 9, p. 3.)

18-2. The ASCAP repertory includes more than a million musical compositions. The exact number constantly changes. (R. 30, Agreed Fact 13, p. 3.)

18-3. ASCAP at all times pertinent, except for a period of time in and around 1959, was and now is engaged in issuing licenses for performances of works in its repertory to broadcasters located in the State of Washington. Such licenses are mailed by ASCAP from New York City, signed by broadcasters in the State of Washington, thence returned and signed by ASCAP in New York City. (R. 30, Agreed Fact 19, p. 5.)

18-4. At all times pertinent hereto, each of the plaintiffs has been paid and received and will continue to be paid and receive royalty compensation and other consideration from ASCAP, some of which money is from broadcasters in the State of Washington. (R. 30, Agreed Fact 20, p. 5.)

18-5. At all times pertinent hereto, broadcasting stations were the only users of music located in the State of Washington from whom ASCAP collected fees. Plaintiffs collected no fees from any other user located in the

State of Washington. (R. 30, Agreed Fact 21, p. 5.)

18-6. ASCAP licenses broadcasting stations on behalf of its members under only two types of licenses, one of which is called "blanket" and the other "per program." (R. 30, Agreed Fact 22, p. 5.)

18-7. The affairs of ASCAP are managed by its Board of Directors, the members of which are elected by the members of ASCAP. The fee to be quoted for any license of the ASCAP repertory is initially determined by the Board of Directors, as distinguished from its members. If a user and ASCAP are unable to agree upon the initial fee or negotiate a fee it may be determined as provided in the Amended Final Judgment of March 14, 1950. (R. 30, Agreed Fact 24, p. 6.)

18-8. The filings (dated July 21, 1961, and August 7, 1962), made by ASCAP with the Secretary of State of the State of Washington, set forth the only forms of licenses which then were and are made available by ASCAP to users in Washington. (R. 30, Agreed Fact 25, p. 6.)

18-9. In the last ten years, neither ASCAP nor any plaintiff has entered into any license agreement with any broadcaster located in the State of Washington on any other basis than the forms referred to in paragraph 23 and similar prior forms. (R. 30, Agreed Fact 26, p. 6.)

18-10. If called, plaintiffs would testify that all plaintiffs have at all times in the last ten years been ready to negotiate with any broadcaster for a license to perform any of plaintiffs' copyrighted musical compositions in the State of Washington on any mutually agreeable basis, including a "per piece rate." If called, defendants and other broadcasters would testify that the defendants

did not ask for per piece licenses from the individual plaintiffs, because to do so would have been a useless and futile act. (R. 30, Agreed Fact 27, p. 16.)

18-11. At all times here pertinent, plaintiffs have received royalties for the publication of their copyrighted musical compositions which are usually paid according to the number of sales of individual sheet music or records. In addition to any royalties so received, plaintiffs also received for the public performance for profit of their copyrighted musical compositions royalties which are paid in accordance with the ASCAP Articles of Association and Membership Agreement as amended by and according to the provisions of the 1950 and 1960 decrees. (R. 30, Agreed Fact 29, p. 7.)

18-12. ASCAP offers licenses in Washington to users of music where fees are charged for performance of specific compositions. (R. 30, Agreed Fact 43, p. 9.)

18-13. Such licenses are not offered to broadcasting stations located in Washington. (R. 30, Agreed Fact 44, p. 9.)

18-14. Music is a necessity to the broadcasting industry in the State of Washington and throughout the United States. (R. 30, Agreed Fact 45, p. 9.)

18-15. The income of any composer, author or publisher of popular music depends primarily on the public performance of such music by broadcasting stations. (R. 30, Agreed Fact 46, p. 9.)

18-16. Very few commercial radio broadcast stations can exist today without access to commercial use of copyrighted music. (R. 30, Agreed Fact 47, p. 9.)

18-17. Three music licensing organizations in the United States license the non-dramatic performing rights of substantially all of the copyrighted musical works in the United States today. ASCAP is one of these organizations and more than 50% of all performances of copyrighted music by broadcasting stations in the United States are licensed by ASCAP and are performances of compositions in which the copyrights are held by members of ASCAP. More than 87% of ASCAP's total revenue is derived from license fees paid by broadcasting stations and networks, and less than 13% from all other uses of music combined. In the State of Washington 100% of ASCAP's collections comes from broadcasters. (R. 30, Agreed Fact 48, p. 9.)

18-18. ASCAP's total revenue in 1962 was $34,841,-010.94. Revenue from radio and television stations and networks was $30,557,084.30 in 1962, and revenue from all other licenses was $4,283,926.62. (R. 30, Agreed Fact 49, p. 9.)

18-19. No broadcaster, including defendants herein, was a party to the anti-trust action brought by the United States of America, entitled *"United States of America v. American Society of Composers, Authors and Publishers,"* Civil Action No. 13-95 (United States District Court for the Southern District of New York). (R. 30, Agreed Fact 50, pp. 9-10.)

18-20. None of the defendants herein, including defendant Rogan Jones, was a party to the action entitled *"United States of America v. American Society of Composers, Authors and Publishers,"* Civil Action No. 13-95 (United States District Court for the Southern District

of New York), in which the Amended Final Judgment was entered on March 14, 1950. (R. 30, Agreed Fact 51, p. 10.)

18-21. Defendant was not consulted by an agent of the United States concerning said legal proceedings prior or subsequent to the said Amended Final Judgment. (R. 30, Agreed Fact 52, p. 10.)

18-22. Defendant was not consulted by an agent or representative of ASCAP concerning said legal proceedings prior to said Amended Final Judgment. (R. 30, Agreed Fact 53, p. 10.)

18-23. Some of plaintiffs, and other members of ASCAP, are subsidiaries of or otherwise affiliated with various record companies. (R. 30, Agreed Fact 54, p. 10.)

18-24. It would be commercially, practicably and virtually impossible for defendant and almost all other broadcasters to acquire a separate license for each performance broadcast over commercial stations. It would be commercially, practicably and virtually impossible for plaintiffs and other composers, authors and publishers to issue a separate license for each performance broadcast over broadcasting stations or to have the payment for such performances on the basis of each individual use. (R. 30, Agreed Fact 50, pp. 10-11.)

18-25. There are approximately 5,469 stations licensed by the FCC and broadcasting in the United States today, the overwhelming majority being commercial broadcasters, with comparatively very few educational broadcasting stations. (R. 30, Agreed Fact 54, p. 11.)

18-26. Movie producers do not acquire the performance rights or any other rights from ASCAP. Performance

for profit rights are generally acquired by networks for their affiliated stations and by background music users for their subscribers, and by movie producers for their movie exhibitors. (R. 30, Agreed Fact 59, p. 11.)

18-27. There are in existence virtually no licenses for the performance rights to music in ASCAP's repertory between individual broadcasters and plaintiffs and other members of ASCAP in which the broadcaster agrees to pay for such performance rights. (R. 30, Agreed Fact 60, p. 11.)

18-28. Each musical copyright is unique (R. 30, Agreed Fact 61, p. 11.)

18-29. ASCAP makes per program licenses available to all broadcasters; fewer than 60 to 100 broadcasters in the United States elect that form of agreement. At the time of the alleged infringement and now, none elect that form in Washington. (R. 30, Agreed Fact 62, p. 11.)

18-35. At the time of the alleged infringement and now, there were and are no licenses in effect between any plaintiff, or to the knowledge of these plaintiffs any other ASCAP member, and any recording company authorizing any broadcasting station to perform publicly for profit any musical composition. (R. 30, Agreed Fact 63, p. 11.)

18-36. Plaintiffs do not permit any other music licensing organization such as Broadcast Music Inc., or SESAC, Inc., to license the performance of the compositions alleged infringed. (R. 30, Agreed Fact 67, p. 12.)

18-37. Plaintiffs do not permit any other such licensing organizations to license the performance of any of plaintiffs' musical compositions. (R. 30, Agreed Fact 68, p. 12.)

18-38. None of the plaintiffs has ever entered into any blanket license with any user in the State of Washington relating to plaintiffs' musical compositions other than through ASCAP and by ASCAP licenses; to defendants' knowledge plaintiffs have received no request from any broadcaster in the State of Washington other than those made through ASCAP for a blanket license relating to plaintiffs' musical compositions. (R. 30, Agreed Fact 69, p. 12.)

18-39. Composers and publishers actively compete to have their music recorded by recording companies and played by broadcasting stations. (R. 30, Agreed Fact 53, p. 12.)

18-40. In 1959 ASCAP refused to offer licenses to any broadcasters located in the State of Washington. Thereafter, on November 20, 1959, the owners of many stations in the state petitioned the United States District Court for the Southern District of New York to issue an order directing ASCAP to issue licenses. (R. 30, Agreed Fact 73, p. 13.)

18-41. On November 20, 1959, the said court issued an agreed order directing ASCAP to issue licenses to the petitioners. Such order (see Exhibit 1 annexed hereto) was issued upon stipulation and agreement of the parties. (R. 30, Agreed Fact 74, p. 13.)

18-42. Defendant and the other broadcasting stations cannot obtain licenses to broadcast any of the compositions contained in ASCAP's repertory except from ASCAP or from each individual member of ASCAP or any other person who has obtained the necessary rights from ASCAP or from the members in interest. (R. 30, Agreed Fact 79, p. 14.)

18-43. Defendant and the other broadcasting stations cannot obtain licenses to broadcast any of the compositions, the performance rights to which are held by plaintiffs, from anyone other than ASCAP or plaintiffs or from each individual member of ASCAP or any other person who has obtained the necessary rights from ASCAP or from the members in interest. (R. 30, Agreed Fact 80, p. 14.)

18-44. Some stations, including some located in Washington, desire certain special styles or kinds of music programming, such as western, religious, "good music," classical and "top 40." (R. 30, Agreed Fact 81, p. 14.)

18-45. ASCAP does not offer licenses to broadcasters for special catalogues of music such as western, religious, "good music," classical, "top 40." (R. 30, Agreed Fact 82, p. 14.)

18-46. The performance rights to some music in ASCAP's repertory is vastly more valuable than the performance rights to other music in ASCAP's repertory, and of all the millions of musical compositions copyrighted very few become hits or of any significant value. This is also true of the performance rights to music written by the plaintiffs. (R. 30, Agreed Fact 83, p. 14.)

18-47. The revenue distributed by ASCAP, pursuant to the consent decree, to its members from performance rights fees cannot be segregated to determine how much money is distributed for any particular composition. (R. 30, Agreed Fact 84, p. 14.)

18-48. ASCAP distributions, pursuant to the consent decree, cannot be allocated to a particular state or area

or to a particular composition. (R. 30, Agreed Fact 84, p. 14.)

18-49. SESAC and BMI license users other than broadcasters in the State of Washington. (R. 30, Agreed Fact 86, p. 14.)

18-50. Under the terms of the application for membership and a member's contract with ASCAP, all of his or its compositions listed in the application for membership or written, composed or published during the term of his or its membership, become part of the ASCAP repertory. (R. 30, Agreed Fact 87, p. 14.)

APPENDIX "B"

Facts Admitted in the Pretrial Order But Omitted from the Findings

(Specification of Error No. 19)

19-1. At all times herein pertinent, certain defendants paid sums to networks which networks paid fees to ASCAP for network licenses for network (but not local) programs. (R. No. 1, p. 1.)

19-2. Said fees were ultimately distributed to the plaintiffs. (R. No. 2.)

19-3. Immediately after defendant Wescoast Broadcasting Co., Inc., refused to enter into agreements on the same terms as had been entered into with other defendants, Wescoast was sued for an additional twenty-eight infringements on which statutory damages would be not less than $7,000 and not more than $140,000, plus costs and reasonable attorneys' fees in such amount as the court deems proper. (R. No. 26, p. 6.)

19-4. Each of the plaintiffs and the other members of ASCAP share in the royalties and fees for performance of music composed, published and owned by other members of ASCAP. (R. No. 29, p. 7.)

19-5. Some of the plaintiffs had no knowledge of the alleged infringements or that any action was being filed. (R. No. 30, p. 7.)

19-6. Not all phonograph records are marked as to the name of the licensing organizations that license the music contained on the record. (R. No. 32, p. 8.)

19-7. Some of the ASCAP's members, including some of the plaintiffs herein, have received thousands of dol-

lars from advertising agencies or other commercial users for the right to use one musical composition as a radio or television commercial. (R. No. 34, p. 8.)

19-8. One advertising agency paid almost $100,000 for the right to use one song published by one of the plaintiffs as a radio or television commercial. (R. No. 36, p. 8.)

APPENDIX "C"

Defendants' Contentions of Fact

(Specification of Error No. 20)

20-1. The plaintiffs, ASCAP, and the other members of ASCAP, at all times pertinent hereto:

(a) Are two or more persons holding or claiming separate copyrighted works, under the copyright laws of the United States, and

(b) Have banded together and pooled their interests for the purpose of fixing prices on the use of said copyrighted works, and

(c) Have pooled their separate interests and conspired, federated and joined together for the purpose of collecting fees in this state, and

(d) Have issued blanket licenses in this state, for the right to commercially use or perform publicly their separate copyrighted works, and

(e) Have not issued licenses to broadcasters or defendants on rates assessed on a per piece system of usage.

20-2. ASCAP licenses broadcasting stations on behalf of its members under only two types of licenses, one of which is called "Blanket" and the other "Per Program." Both the per program license and the blanket license are blanket licenses, that is, the user has the right to use everything in the repertory without getting any special permission. ASCAP does not offer broadcasters any other kind of license.

20-3. At all times pertinent hereto, neither ASCAP nor any of the plaintiffs has ever offered licenses to broadcasting stations in the State of Washington where fees are charged according to the number of performances

broadcast, i.e., on a basis of so much money per performance for profit.

20-4. ASCAP does not now offer to broadcasting stations licenses based upon a per piece rate as described in RCW 19.24, *et seq.*

20-5. Plaintiffs individually do not now offer such licenses.

20-6. Plaintiffs individually did not offer such licenses at the time of the alleged infringement.

20-7. Neither ASCAP nor plaintiffs has ever issued such a license to broadcasting stations in the State of Washington, and no such licenses are in use in Washington.

20-8. The fees provided for in ASCAP's blanket and per program licenses offered broadcasting stations in Washington have no relation to the amount of ASCAP's music that is played on a broadcasting station.

20-9. The filings (dated July 21, 1961, and August 7, 1962) made by ASCAP with the Secretary of State of the State of Washington do not include any licenses for broadcasting stations based upon a per piece system of usage, and list the only licenses available to them as blanket type licenses.

20-11. None of the plaintiffs has ever filed a copy of any per piece license for use by broadcasting stations as described in RCW 19.24, *et seq.*, with the Secretary of State.

20-12. The ASCAP membership contract contains the following terms which have not been modified by the consent decree:

(a) "The Society agrees, during the term hereof, in good faith to use its best endeavors to promote and carry out the objects for which it was organized, and to hold and apply all royalties, profits, benefits and advantages arising from the exploitation of the rights assigned to it by its several members, including the *Owner,* to the uses and purposes as provided in its Articles of Association (to which reference is hereby made), as now in force or as hereafter amended.

(b) "The *Owner* hereby irrevocably, during the term hereof, authorizes, empowers and vests in the *Society* the right to enforce and protect such rights of public performance under any and all copyrights, whether standing in the name of the *Owner* and/or others, in any and all works copyrighted by the *Owner,* and/or by others, to prevent the infringement thereof, to litigate, collect and receipt for damages arising from infringement, and in its sole judgment to join the *Owner* and/or others in whose names the copyright may stand, as parties plaintiff or defendants in suits or proceedings; to bring suit in the name of the *Owner* and/or in the name of the *Society,* or others in whose name the copyright may stand, or otherwise, and to release, compromise, or refer to arbitration any actions, in the same manner and to the same extent and to all intents and purposes as the *Owner* might or could do, had this instrument not been made.

(c) "The *Owner* hereby makes, constitutes and appoints the *Society,* or its successor, the *Owner's* true and *lawful attorney,* irrevocably during the term hereof, and in the name of the *Society* or its successor, or in the name of the *Owner,* or otherwise to do all acts, take all proceedings, execute, acknowledge and deliver any and all instruments, papers, documents, process and pleadings that may be necessary, proper or expedient to restrain infringements and recover damages in respect to or for the infringement or other violation of the rights of public performance in such works, and to discontinue, compromise or refer to arbitration any such proceedings or actions, or to make any other disposition of the

differences in relation to the premises." (Agreement, *ibid.*)

20-13. ASCAP has authority to settle these actions.

20-14. ASCAP, through its agents and legal representatives, has at all times pertinent hereto *threatened* broadcasting stations, including defendant, with suits for infringement of copyrighted musical compositions claimed by its members unless such stations sign one of the two types of blanket licenses.

20-15. ASCAP, through its agents and representatives, continues to make such *threats.*

20-16. ASCAP *threatens* to see that more suits for alleged infringements of copyrighted musical composition claimed by its members are filed against defendant and other broadcasting stations in Washington

20-17. Several broadcasting station defendants have recently negotiated *settlements* of their suits. Immediately thereafter, plaintiffs herein and ASCAP threatened to sue other stations unless they also settled.

20-18. Immediately after defendant *Wescoast Broadcasting Co., Inc.,* refused to settle on the same terms as several other defendants had, Wescoast was sued for an additional twenty-eight infringements, amounting to $7,000.00 plus costs and attorneys' fees.

20-19. Several small radio stations recently sued by ASCAP have had to settle by signing ASCAP blanket licenses and pay the fees required thereunder because of the tremendous *costs of litigation* and threats of further prosecution.

20-20. Each of the plaintiffs, together with ASCAP,

realized the hardship and costs of litigation and relies upon this fact as a means to *intimidate* and *coerce* stations into signing blanket licenses.

20-21. Each of the plaintiffs, with ASCAP, sued the defendant and other defendants in a *concerted campaign* to force defendant to sign a blanket-type license.

24-22. At all times pertinent, each of the plaintiffs and ASCAP has:

(a) Attemped to use the federal courts as innocent instrumentalities in the furtherance of a systematic campaign and scheme designed to illegally fix prices for the commercial use of copyrighted works in Washington, and

(b) Used extortionate means and terrorizing practices based on threats of suits, and

(c) Abused both state and federal process.

20-23. The only licenses offered by ASCAP to radio and television stations in the State of Washington require that defendant subscribe to all of the music in ASCAP's repertory, including the music of many composers and publishers not a party to this action, whether defendants desire the right to play that music or not and regardless of whether defendants have played the music or ever will play it.

20-24. So long as he remains a member, the member may not assign or license the performance rights to *recording* companies.

26-25. ASCAP is the only one who can license *recording* companies.

20-26. No one has asked for licenses for *recording* companies authorizing broadcasting stations to perform

musical compositions publicly for profit, because to do so would have been *useless* and futile.

20-27. Broadcasters in the State of Washington have not asked individual plaintiffs for licenses, because to do so would have been *useless* and *futile.*

20-28. The plaintiffs, together, and with ASCAP and the other members of ASCAP, at all times pertinent, and now:

(a) Engage in and are parties to a combination, conspiracy and contracts, agreements and understandings among themselves in unreasonable restraint of interstate trade and commerce in music performance rights;

(b) Fix, stabilize, regulate and affect the *price* of music and performance rights thereto, and establish and maintain uniform and non-competitive prices for such rights;

(c) Prohibit broadcasters from obtaining performance rights to music on records with the purchase or other acquisition of records, i.e., *clearance at the source;*

(d) *Pool* performance rights to music among themselves:

(e) *Share* in the royalties and fees for performance of music composed, published and owned by other members of ASCAP;

(f) Violate the provisions of the amended *consent judgment* entered in the United States District Court referred to above, by preventing them from having a *genuine economic* and competitive choice between ASCAP and individual member licenses and between blanket and per program licenses;

(g) Coerce and compel defendant and other broadcasters, in order to continue in business, to acquire from ASCAP one of two types of blanket licenses for the performance rights to all the copyrighted musical compositions in the ASCAP repertory, whether defendants and other broadcasters have need for or actually use the same or not;

(h) Coerce broadcasters to accept *blind selling* practices;

(i) *Condition* the *license* of the rights of performance for profit of usable or desirable music on the license of their entire repertory which contains unwanted, unusable and undesirable music;

(j) Make the so-called right to deal with individual members of ASCAP, *illusory* because of the thousands of ASCAP members, the hundreds of thousands of compositions involved, the rapidity at which music is composed, published and popularized, the immediacies of everyday broadcasting, and the charges demanded;

(k) *Restrain competition among themselves* in the performance rights market place and stifle the ability of nonmembers to market their music by practices of pooling rights, price fixing, block booking, sharing fees and dealing almost exclusively through ASCAP.

(l) Restrict incentive for *young* and/or *new* composers or writers;

(m) *Tie* the sale and purchase of poor music to good music and thereby artificially equalize the reward to members and prevent remuneration from being related to quality;

(n) *Discriminate against broadcasters* who must compete with other users of music such as motion picture theaters, recreation centers, symphonies and background music disseminators by failure to license them, failure to enforce copyrights, charging disproportionate fees and granting them clearance at the source.

(o) *Stifle* the flow of music to the *public* and the incentive of would-be composers and authors to create new music for the enlightenment and enjoyment of the public.

20-29. A substantial portion of the license fees for performance rights licensed to broadcasters represents the *cost of unused music.*

20-30. All defendants have at all times here pertinent been *ready to negotiate* and pay fees for the performance of plaintiffs' or other copyright holders' copyrighted works where the right to perform has been previously acquired at the *source* as is the practice with networks, jingles and transcribed programs.

20-31. All defendants have at all times pertinent been ready to *negotiate* and pay fees for the right to perform copyrighted works on *records* where such right has been cleared for performance by broadcasting stations.

20-32. All defendants have at all times here pertinent been ready to *negotiate* and pay fees for the right to perform copyrighted music when fees are charged on the basis of so much money per time a *piece* of music is played.

20-33. Broadcasting stations *compete* with other broadcasting stations and other *entertainment businesses* such as nightclubs, restaurants, theaters, bowling alleys, sym-

phonis and motion picture theaters for the public's time and attention.

20-34. Performance rights for music on *motion picture* films, some jingles, transcribed programs and television programs are *negotiated on an individual basis.*

20-35. Some stations, including the defendants herein, do not desire to broadcast all types, kinds or *styles of music* available.

20-36. It would be impossible for the defendants to operate their radio stations without music licensed by ASCAP.

20-37. The dissemination and commercial use of music when performed publicly and broadcast by radio and television stations is a business affected with the *public interest.* Music is a commodity of general business necessity and use throughout the United States.

20-38. Broadcast stations supply a necessity and their business affects the public interest.

20-39. Radio stations affiliated with networks, other than those originating networks broadcasting, have no *control over the selection* of the musical compositions which are performed on the network and received by the affiliate.

20-40. Broadcasting is the principal medium through which individual musical compositions are transmitted to the ear of the public.

20-41. Blanket licenses destroy the *incentive* of broadcasting stations and individual composers and authors to bargain among themselves for performance rights and destroy the incentive of broadcasters to perform the

music of composers and authors not members of the blanket licensing organization.

20-42. The "Blanket" and "Per Program" licenses offered by ASCAP both require payment charged upon income received by broadcasters for time devoted to the broadcasting of matters such as *news, lectures, discussion,* public events and sporting events, which employ none of the copyrighted music of the plaintiffs or members of ASCAP, or any music whatsoever.

20-43. The *Federal Communication Commission* requires broadcasters to devote time to public events, public issues and service, sporting events, discussion and matters of current community interest which do not normally employ the use of music.

APPENDIX "D"

Specific Violations of the Federal Antitrust Laws Contended by Appellant in the Pretrial Order

(Specification of Error No. 42)

42-1. Unlawfully extending the copyright laws.

42-2. Acquiring a monopoly on the separate monopolies granted by the United States copyright laws in derogation of such laws and the anti-trust laws.

43-3. Combining, conspiring and agreeing to restrain trade or commerce in music, including the performance rights of music, among the several states.

42-4. Pooling copyrights and fixing prices therefore, and claiming rights under and entering into contracts, agreements and undestandings among themselves, with ASCAP and the other members of ASCAP, other persons and organizations having or controlling music and rights connected therewith, which restrict the use of music and rights connected therewith.

42-5. Refusing to issue to defendants and other broadcasters licenses based at a fee or rate which is assessed on actual use or number of performances or licenses for special catalogues of music such as western, religious, concert, as distinguished from existing blanket type licenses.

42-6. Conditioning the license of performance for profits rights of useable or desirable music on the license of their entire repertory which contains unwanted, unuseable and undesirable music.

42-7. Discriminating against defendants and other com-

mercial users of music as to types of licenses offered, prices charged, methods of collection, and means of enforcement.

42-8. Issuing blanket licenses in the State of Washington which violate said state's laws.

42-9. Prohibiting broadcasters from obtaining performance rights to music on records with the purchase or other acquisition of the records.

42-10. Refusing in concert with other music copyright owners to issue music performance licenses which exclude pre-recorded material which has been cleared at the source for public performance.

APPENDIX "E"

Specific Injunctive Measures Sought by Appellant in the Pretrial Order

(Specification of Error No. 43)

43-1. Combining or conspiring or agreeing to restrain trade or commerce in music, including the performance rights of music, among the several states.

43-2. Claiming any rights under or entering into any contract, agreement or understanding among themselves, with ASCAP or the other members of ASCAP or other persons or organizations having or controlling music or rights connected therewith which restrict the use of music or rights connected therewith.

43-3. Refusing to issue to defendants or other broadcasters licenses of specialty catalogues or licenses based on a system of usage at a fee or rate which is assessed on actual use or number of performances and as distinguished from existing blanket license rates based on music never used, and which fee or rate is economically fair, practical and reasonable.

43-4. Block booking.

43-5. Discriminating among defendants and other commercial users of music as to types of licenses offered, prices charged, methods of collection, and means of enforcement.

43-6. Issuing blanket licenses in the State of Washington which violate said state's laws.

43-7. Suing for infringment of plaintiffs' copyrighted works until such time as plaintiffs comply with all provisions the court may order, adjudge and decree, and

until such times as plaintiffs comply in all respects with the laws of the State of Washington, the Federal anti-trust laws and the Federal copyright laws.

43-8. Prohibiting record companies from obtaining performance rights so as to enable broadcasters to perform music on recordings without obtaining a separate performance rights license.

43-9. Refusing in concert with other music copyright holders to issue music performance licenses which exclude pre-recorded material which has been cleared at the source for public performance.

APPENDIX "F"

Statutes Involved

The Copyright Law

Section 1 of the Copyright Law, 17 U.S.C. Sec. 1 provides in pertinent part:

> "Sec. 1. Exclusive rights as to copyrighted works
>
> "Any person entitled thereto, upon complying with the provisions of this title, shall have the exclusive right: * * *
>
> * * *
>
> "(e) To perform copyrighted work publicly for profit if it be a musical composition; . . ."

Section 101 of the Copyright Law, 17 U.S.C. Sec. 101, provides in pertinent part:

> "Sec. 101. Infringement
>
> "If any person shall infringe the copyright in any work protected under the copyright laws of the United States such person shall be liable:
>
> "(a) Injunction.—To an injunction restraining such infringement;
>
> "b" Damages and profits; amount; other remedies. —To pay to the copyright proprietor such damages as the copyright proprietor may have offered due to the infringement, * * * or in lieu of actual damages and profits, such damages as to the court shall appear to be just, and in assessing such damages the court may, in its discretion, allow the amounts as hereinafter stated, * * * and such damages shall in no . . . case exceed the sum of $5,000 nor be less than the sum of $250, and shall not be regarded as a penalty."

Section 116 of the Copyright Law, 17 U.S.C. Sec. 116, provides:

Sec. 116. Costs, attorney's fees

"In all actions, suits, or proceedings under this title, except when brought by or against the United States or any officer thereof, full costs shall be allowed, and the court may award to the prevailing party a reasonable attorney's fee as part of the cost."

The Sherman Act

Section 1 of the Sherman Act, 15 U.S.C. Sec. 1, provides in pertinent part:

"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . ."

Section 2 of the Sherman Act, 15 U.S.C. Sec. 2, provides in pertinent part:

"Every person who shall monopolize or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be guilty of a misdemeanor."

Section 3 of the Clayton Act, 15 U.S.C. 14 provides, in pertinent part:

"That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise,

machinery, supplies or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

Section 4 of the Clayton Act, 15 U.S.C. 15, provides, in pertinent part:

"That any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States, in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fees."

Section 16 of the Clayton Act, 15 U.S.C. Sec. 26, provides, in pertinent part:

"Any person, firm, corporation, or association shall be entitled to sue and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss of damage by a violation of the antitrust laws, including Sections 13, 14, 18 and 19 of this title, when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity, under the rules governing such proceedings, and upon the execution of proper bond against damages for an injunction improvidently granted and a showing that the danger of irreparable loss or damage is immediate. . ."

Washington Statutes

RCW 19.24.020, provides, in pertinent part:

"It shall be unlawful for two or more persons holding or claiming separate copyrighted works under the copyright laws of the United States, either with-

in or without the state, to band together, or to pool their interests for the purpose of fixing the prices on the use of said copyrighted works, or to pool their separate interests or to conspire, federate or join together for the purpose of collecting fees in this state, or to issue blanket licenses in this state, for the right to commercially use or perform publicly their separate copyrighter works: *Provided, however,* such persons may join together if they issue licenses on rates assesed on a per piece system of usage: *Provided, further,* This act shall not apply to any one individual author or composer holder or owner who may demand any price or fee he or she may choose for the right to use or publicly perform his or her individual copyrighted work or works: *Provided, further,* Such per piece system of licensing must not be in excess of any per piece system in operation in other states where any groups or persons affected by this act does business, and all groups and persons affected by this act, are prohibited from discriminating against the citizens of this state by charging higher or more inequitable rates per piece for music licenses in this state than in other states. . . ."

RCW 19.24.040, provides, in pertinent part:

'In the event two or more persons holding separate copyrighted musical works, or any rights flowing therefrom, whether by assignment, agency agreements, or by any form of agreement, pool their interests, or combine, or conspire, federate, or join together in any way, whether for a lawful purpose or otherwise. a complete list of their copyrighted works or compositions shall be filed once each year in the office of the secretary of state of the State of Washington, together with a list of the prices charged or demand for their various copyrighted works; no payment or filing fee shall be required by the secretary of state, and said persons, corporations, or association, foreign or domestic shall state therein under oath, that said list is a complete catalogue of the titles of their claimed compositions,

whether musical or dramatic or of any other classification, and in addition to stating the name and title of the copyrighted work it shall recite therein the date each separate work was copyrighted, and the name of the author, the date of its assignment, if any, or the date of the assignment of any interest therein, if any, and the name of the publisher, the name of the present owner, together with the addresses and residences of all parties who have at any time had any interest in such copyrighted work. The secretary of state shall require two copies of said list, one of which he shall keep on file, the other shall be forwarded to the office of the state Treasurer at Olympia."

RCW 19.24.050, provides, in pertinent part:

'The foregoing list of names and titles, provided for in the preceding section, shall be made available by the secretary of state to all persons for examination, in order that any user of copyrighted works in this state may know the rights and the titles to such copyrighted works as may be claimed by any of said combinations, pools, associations, or persons as aforesaid; said lists shall be prepared so that all persons may avoid using said copyrighted compositions, if they so desire, and may avoid conflict therewith, and avoid committing innocent infringements of said works; and in order to further effectuate the copyright laws of the United States, the secretary of state shall, if he deems it necessary to protect the citizens of this state from committing innocent violations of the copyright laws of the United States, publish such list once a year in a newspaper of general circulation, in order that all citizens of the state may respect any and all individual rights granted by the United States copyright laws."

RCW 19.24.055 provides, in pertinent part:

"No person, corporation, or association, domestic or foreign, whether doing business in this state as hereinafter defined or not, shall be absolved from the foregoing duty of filing said list of holdings as

required in the preceding sections of this chapter, if their music or copyrighted works are used commercially in this state, or have been used herein, whether originating from a point within the state or from without, and as long as any rendition thereof is received or heard within the state, or is intended to be so received by the originator of any musical program; *Provided, however,* Any individual owner of a copyrighted work or works, not a party to or not connected in any way with any pool, conspiracy, combination, or groups, or associations of persons, as prohibited by this chapter, need not file any such list."

RCW 19.24.060 provides, in pertinent part:

"It is hereby declared that the production and creation of music and the commercial use of music and of copyrighted works within this state, whether originating at a point from within or without the state, as long as the same shall be rendered and publicly received within the confines of this state, whether mechanically or by radio communication, is a big business clothed and affected with the public interest and the adult educational advantages engendered by the public use of music and in its creation, makes this business one of public necessity, and necessary for the education and training of the youth of this state; that many abuses are practiced under a false guise of Federal protection which only the state with its police power can easily and lawfully restrain, and in order to prohibit, discourage, and prevent monopolistic practices, and to prevent extortion, to encourage free bargaining between the citizens of this state with each other and with those without the state, and in order to give greater effect to the constitutional provisions relating to monopoly and price fixing, and in the general interest of the public, therefore, the legislature in the interest of the peace and dignity of the state, in the interest of good morals and general welfare of the people of this state, and for greater educational advantages to the public, de-

clares that said business shall be subject to the police power and reasonable regulation of the state government, and such police and regulating power shall be administered by the courts and other officials of this state in a manner consistent with, in aid of, and never in conflict with the copyright laws of the United States. The provisions of this act, and the administration thereof, shall at all times effectuate the enforcement, the true intent, and meaning of the United States copyright laws in order to prevent abuses from being practiced within this state from points within or from points without the state, by any individual, corporation, or organizations, who attempt to use the Federal courts as innocent instrumentalities in the furtherance of any systematic campaign or scheme designed to illegally fix prices for the commercial use of copyrighted works in this state through the use of extortionate means and terrorizing practices based on threats of suits, and an abuse of both state and Federal process, all of which are declared to be in violation of this act and of the state constitution, and it is further declared that any person or persons, or combines, as aforesaid, who shall violate this act shall be deemed to have used their property within this state in such a way that the same shall have acquired a legal situs, analogous to the situs of other personal tangible property within the state, even though separate from the domicile and residence of the owner; *Provided, further,* The legal situs of any copyrighted work is coextensive about the state, and a copyrighted work used or sold for public use or public performance for profit, if intended to be heard from a point without the state or from a point within the state, is hereby declared to be a commercial commodity, and its legal situs is hereby declared to be within the State of Washington."

(The balance of RCW 19.24.060 is also pertinent to this case. It is recited in full in Appendix "A" which is attached hereto. Paraphrasing it makes the "production," "creation" and "commercial use of music" in this state

a business "clothed and affected with the public interest" and of "public necessity.")

RCW 19.24.100 provides, in pertinent part:

> "... and all licenses of any violator of this chapter shall be deemed as aiders and abettors of said persons and subject to the provisions of this chapter unless they forthwith indicate their obedience herewith...."

RCW 19.24.290 provides, in pertinent part:

> "Every person, in addition to the other penalties provided in this chapter, who violates or who procures, or aids or abets in the violating of any provision of this chapter, or who conspires to render ineffectual any valid order or decision of any court in the enforcement of this chapter, or who procures, conspires with, or aids or abets any person or persons in his or their failure to obey the provisions of this chapter, or to render ineffctual any valid order of any court in connection with the enforcement of this chapter shall be deemed guilty of a gross misdemeanor, and upon conviction, shall be punished by a fine not exceeding five hundred dollars ($500), or imprisonment in the county jail for not more than six months (6), or both such fine and imprisonment."

The Washington Constitution

Article XII, Sec. 22, of the Constitution of the State of Washington, provides:

> "Sec. 22. MONOPOLIES AND TRUSTS. Monopolies and trusts shall never be allowed in this state, and no incorporated company, co-partnership, or association of persons in this state shall directly or indirectly combine or make any contract with any other incorporated company, foreign or domestic, through their stockholders, or the trustees or assignees of such stockholders, or with any co-partnership or association of persons, or in any manner

whatever for the purpose of fixing the price or limiting the production or regulating the transportation of any product or commodity. The legislature shall pass laws for the enforcement of this section by adequate penalties, and in case of incorporated companies, if necessary for that purpose, may declare a forfeiture of their franchise."

APPENDIX "G"

Testimony of Rogan Jones, President of International Good Music, Inc., and Wescoast Broadcasting Co., Owners of KGMI, Bellingham, Washington, and KPQ, Wenatchee, Washington, respectively.

"THE WITNESS: No, I am not trying to get ASCAP's music for nothing. I think it might be cleared at the source as it is for movies.

"There are two basic viewpoints in our position.

"One is that the juke box people get their music for nothing and theaters get their music for nothing. The record people get their music for a limited amount.

"We add greatly to the value of all the music that we play, which is the reason we get records for nothing and for a discount price. We think that we should have credit for this.

"And the other point is that we think that in the land of free enterprise we should have the right to bargain for the price we pay for these."

"THE COURT: In other words, what really disturbs you is the fact that the juke box operators, by statute, are in a preferred position?

"THE WITNESS: Well, the theater people are, too.

"THE COURT: The theater people, don't they pay for their music when they buy the film?

THE WITNESS: We think we do when we buy a record.

THE COURT: You mean the two cents?

"THE WITNESS: Yes.

"THE COURT: And most of the records you get for free?

"THE WITNESS: Well, no, we get these records, Your Honor, because of what we add to the value of the record and the music that we play. This is the

thing that is overlooked. We add to the value of the music we play.

"THE COURT: In other words, by playing music you encourage people to buy records?

"THE WITNESS: Correct, sir, and we thereby add to the value of the copyright holder.

"Q. (By MR. TOPKIS): Mr. Jones, in the bargaining that you indulge in with these composers, authors, publishers, which way would you contemplate payment would go? Should you pay them or should they pay you in this land of free enterprise?

"A. I am not sure whether some of them would not be called to pay us. This is why we had payola."

APPENDIX "H"

Testimony of Lincoln W. Miller, Assistant President, Queen City Broadcasting Company, owner of KIRO and KIRO-TV, Seattle, Washington.

"Q. (By MR. MURPHY): Would it be commercially possible for a radio station to negotiate with ASCAP as distinguished from its members for specific compositions?

"A. For the right to use?

"Q. For the right of use—specific—

"A. Individual compositions?

"Q. Right.

"A. I would certainly think not because, there again, ASCAP is located clear to the other end of the country, and for each tune we might be interested in we would have to make a separate trip, goodness knows how many days talking, and we still might not get it because the price might not be right.

"Q. If you had a price list that was determined and you could see, could you then?

"A. That could certainly expedite matters, yes.

"THE COURT: How would your position be improved if you negotiated on a per piece basis? As I understand it, you play music eight hours out of twelve hours a day. What difference does it make whether you play Irving Berlin or Cole Porter during that period? You would have to pay for what you are playing, wouldn't you?

"THE WITNESS: Under the present arrangement, certainly, we pay for it on a blanket basis which is simply a percentage of the gross income we take in.

"THE COURT: Suppose you were paying on a per piece basis. How would that improve your situation?

"THE WITNESS: It could improve it substantially

from the monetary standpoint because we would then have a different price on these different pieces.

"THE COURT: So you can take out cheaper pieces?

"THE WITNESS: Right, but some of the cheaper pieces might be better for a balanced program, and we might add to it, Your Honor.

"We try to adjust what we call the sound because it is different from other stations so we might want to play all western or all religious, so in the case of our station we try to balance with a little bit of everything, but if we knew what the price tags were, this could well influence the kind of music we play and balance with the kind of music we play. It would certainly influence our decision because the economics would be right in front of us. We would be free to determine.

"MR. MURPHY: No further questions.

Testimony of James W. Wallace, General Manager, Wescoast Broadcasting Company, Owner of KPQ, Wenatchee, Washington.

"Q. (By MR. MURPHY): Mr. Wallace, would it be expensive or (Page 210) inexpensive, or what would be the effect if you had a list of all music available and the price for each one of those pieces of music? Could you allocate a price to music and then pick and choose?

"MR. TOPKIS: Objection.

"THE COURT: I am going to let him answer, but I doubt whether he would be qualified to answer the question. There are many different ramifications in a plan of that kind, but I will be glad to hear what you have to say, Mr. Wallace.

"THE WITNESS: I started out as an engineer. I keep index cards. I know exactly what music we play. We have a list of it.

"As to how I arrive at knowing what the music should be, I should give you a background. I have

gone through all the offices, President of the Chamber of Commerce, United Good Neighbors, Boy Scouts of America (holder of the Silver Beaver award); I am active in Rotary, Chamber of Commerce, and these things are all necessary for a small town radio station man to know what the people want.

"For one thing, almost sixty percent of our income comes from sources other than music. 44 percent is based on the F.C.C. license for that work, and I can do it on any day or month that might be desired, but still we are obligated under any contract offered us by ASCAP to pay on the total (Page 211) amount and not on that portion of the music we need.

"To answer the question directly, with a list which I have I can insert prices on it very readily if they are available, and I would know exactly what our music cost per day or per month or what would be due ASCAP, and it would not be burdensome.

Testimony of Lee Facto, Vice President, International Good Music, Owner of KGMI, Bellingham, Washington.

"THE WITNESS: May I have the question, please?

"THE COURT: He said is that a feasible way of doing business to deal with the composer on a per piece basis?

"THE WITNESS: Yes, I believe it is.

"THE COURT: Have you done it recently?

"THE WITNESS: No, sir, because at the present time I do not believe at the present time it is practical, but that is not to say that it would not be practical.

"MR. RONALD MURPHY: Would you explain this to the court in your own words.

"MR. TOPKIS: I object to that.

"MR. RONALD MURPHY: In your own words.

"THE WITNESS: Well, I think it is a matter of methodology only, not principle. For example, the present method of doing business with respect to copyrights came into being a long time ago. Since that time there has been a great amount of progress in all fields.

"We feel it would be very, very feasible to operate on a per piece basis if we had access to the information as to who owns the copyright.

"MR. TOPKIS: I thought he wanted to deal with the individual composer.

"THE COURT: Just a minute. You will have the right to cross-examine.

"Q. (By MR. RONALD MURPHY): What about price? Go ahead.

"A. As I say, I do feel that it would be practical to deal indiviually with the composer or through a group such as ASCAP on an individual, per play basis, and I think this could well be very advantageous to all concerned, particularly to a radio station inas much as this would allow them to bargain for the price of the music as they do in anything else they buy."

(Page 267 and lines 1-13, page 268, omitted. Commencing with line 14, page 268):

"THE WITNESS: Well, I feel that, first of all, you need information as to who owns a particular piece of music, and, secondly, information as to how much you would have to pay to use the selection on a one-time basis or on a three-time basis or on a five-time or whatever the rate happened to be.

"Beyond this, once you have this information, I believe most stations keep fairly good track of the music they play. They know exactly how many times they play it. If they knew exactly how much it was going to cost them to play it each time, they could actually write the individual composer a check with-

out authorizing an agreed procedure (p. 269) between the composer and the station and any group of representing associates.

"THE COURT: Would you also take into consideration the time in which the piece was played, whether it was at midnight or six o'clock in the evening or eight o'clock in the morning?

"THE WITNESS: Well, if you had that on an individual per piece basis, I think not, Your Honor.

"THE COURT: You think it does not make any difference and the listening public would not have anything to do with how much you would pay?

"THE WITNESS: No, frankly, I think there are a great number of things which make up this product which a radio station sells. Music is one of them. There are news as has been in the testimony here; there is talk about that music; there is personality; there are all these other things. Now, it turns out that music is the only thing which a radio station is not allowed to bargain for as a practical matter under the present methodology. This is what I propose or I am saying. I think there is a practical way to do this to the benefit of everyone.

Lee Facto continued at line 7, page 284:

"Q. What kind of circumstances are those?

"MR. TOPKIS: If Your Honor please, I press my objection to his lack of qualifications.

"THE COURT: You have already covered this in your direct. You cannot go back on that now. You have covered this.

"MR. RONALD MURPHY: Well, if the court please, I think there may be some confusion. I think he should be able to explain what those circumstances are. He should be able to make it clear on the record what he means.

"THE COURT: Proceed. What are those circumstances?

THE WITNESS: The circumstances are where the information as to the copyright held and the price to be charged for the music is readily available on the record, on a list in a catalogue of some sort so that at the point of receiving the record we could determine for this particular record and for this amount of money do we want to play this record, and if we decided at that time that the record was worth the amount of money being asked, we would pay it. If we determined that it wasn't we would not play the record.

MR. RONALD MURPHY: No further questions.

Testimony of Rogan Jones, President, International Good Music, Inc., owner of KGMI, Bellingham, Washington and KPK, Wenatchee, Washington.

"Q. (By Mr. Murphy) If you had a list of music, and that music had by it a cost of each individual piece of music, can you operate your radio station by referring to that list of music and paying a certain price for it?

"MR. TOPKIS: Is that a question at the end?

"MR. MURPHY: Yes.

"THE WITNESS: Yes.

"MR. TOPKIS: I object to it.

"THE COURT: Objection overruled.

"THE WITNESS: We could do this very simply, very economically and very practically.

"Q. (By Mr. Ronald Murphy) Would you explain this to the court how it could be done?

"A. The music is picked in our case from these tapes, but if we were going to live records there would be no trouble in picking the music the day before and then running down the prices that evening, and if a price was too big, we could lay that one aside and put on another piece with a price lower. (page 303)

"THE COURT: What would you regard as a price too big?

"THE WITNESS: Well the—on the basis of the present ASCAP contract, the price that we would have to pay would be approximately five cents per selection. This is on the basis of 2 plus per cent and the approximate number of records that we play per day.

"THE COURT: Then you think that five cents would be too much?

"THE WITNESS: No, I think five cents might not be an unreasonable price, but as a free enterpriser I think I ought to have a chance to bargain.

"THE COURT: Then what you object to is Judge Ryan's stipulation that ASCAP is required to charge the same rate to you as it does to a little station?

"THE WITNESS: Yes.

"THE COURT: You think you are entitled to a little advantage because you are bigger?

"THE WITNESS: No, sir. May I illustrate, sir?

"THE COURT: Yes.

"THE WITNESS: There are two automated stations in Bellingham. One does about $1,800 a month in gross business. We supply him his music on tapes, and it is substantially the same music that we use on our own station except that ours is announced and his is unannounced, and we gross about twelve to fifteen thousand dollars a month, and we spend over and (p. 305) above what it costs for the music. We spend a great deal of money on good announcing, on good sports, on good news, on many things.

"But music is one of the very basic costs of operating a good radio station. There are many, many thousands of dollars that go into other things not connected with music, and we think we ought not to have to pay a percentage of our gross in competition with this other boy that does not spend anything. We think this is severe competition.

"THE COURT: You charge more advertising rates than other people?

"THE WITNESS: Yes, sir, but we spend it back. We spend it in many, many ways, sir. Our newsman, our newsman gets about $800 a month. We could hire one for $350, but he would not do as good a job. I am talking about the local newsman, sir.

"We have a farm show where the farm editor gets paid specially and doesn't run any music, but ASCAP wants a percentage of this gross income.

"I would say that our music cost to put on music on our station probably represents ten per cent of our over-all expenses, and the other ninety per cent has nothing to do with music.

"THE COURT: Do you select the compositions? (p. 305)

"THE WITNESS: No, sir, I do not. I can't even play on the floor very well.

"THE COURT: Proceed. Is there any other question of Mr. Jones?

"Q. (By Mr. Ronald Murphy) Does your station also broadcast certain material which has been, the music in connection with it, which has been, as the term has been bandied about here, cleared for performance, the music has been cleared?

"MR. TOPKIS: Your Honor—

"THE COURT: Objection overruled.

"MR. TOPKIS: You are saving me wear and tear on my vocal cords, Your Honor.

"THE WITNESS: We get the network music, and we get some of these promotional pieces like Wallace described, for our public service. As far as we know, the music is cleared at the source of all that.

"Q. (By M. Ronald Murphy) If all performance rights were indicated on the record as cleared, would this—and had a price on it, could you then pick

and select the music that you put on your station according to that price?

"A. Oh, yes; that would be very simple, and we would be in a position to pay as we would pay anybody else for anything else, as our credit is good. Our hands are clean, and we would have no objection of we had the choice of what we could play or didn't play. (page 307)

"Q. You have no choice now?

"A. No, not under an ASCAP contract. We pay a percentage of our gross, and to this then we object."

Rogan Jones continued, commencing on page 315, line 19:

"THE WITNESS: My thinking, sir, is that if the music were priced by separate pieces, that some would be more expensive than others and that we could use—we could then trade our position so that we could finally bring the price down to a reasonably equitable basis.

"THE COURT: Isn't it a fact that the tunes that you do play are the result of public demand? You have to play certain types of tunes; otherwise, people will not listen to your station? (page 315)

"THE WITNESS: Not necessarily, sir.

"THE COURT: You create the demand yourself?

"THE WITNESS: No, but out of 200 pieces that we play in a given day there are probably 500 pieces that we could have played that day. We have to use our own judgment as to what 200 out of the 500 to play. We do, however, do something that is not customary in the industry. We have a daily, six days a week, six hours a day, survey on an audience of our station and all the stations in the town, and in 48 months we have been number one, 40 months, number two. This we use as a guide in the selection of our music." (page 316)

APPENDIX "I"

McCANN-ERICKSON, INC.
800 BELL, HOUSTON, TEXAS 77002

February 14, 1964

Commercial Manager
Radio Station KGMJ
Bellingham, Washington

Re: Humble Oil & Refining Company
ASCAP License

Dear Sir:

As you may know, Humble Oil annually buys a spot schedule of 60-second announcements in the summer. This year, some of our commercials to be used will incorporate a composition which requires that all stations using the material be licensed by ASCAP.

We have checked your station listing in the current STANDARD RATE & DATA catalog. Nowhere in your listing is information contained to indicate whether your station is licensed by ASCAP.

Please indicate on the enclosed copy of this letter whether or not you have an ASCAP license, and return the information to this office promptly. Your attention to this matter will be greatly appreciated.

Repeating, your station will not be eligible to be considered for our summer spot scheduling unless you do have an ASCAP license.

Sincerely,

[Janice Meredith (Miss)]
Broadcast Traffic

DO HAVE ASCAP LICENSE.....

DO NOT HAVE ASCAP LICENSE.....

SIGNED.....STATION.....

CAPACITY.....DATE.....

McCANN-ERICKSON, INC.
800 BELL, HOUSTON, TEXAS 77002

February 14, 1964

Commercial Manager
Radio Station KWYZ
Everett, Washington

Re: Humble Oil & Refining Company
ASCAP License

Dear Sir:

As you may know, Humble Oil annually buys a spot schedule of 60-second announcements in the summer. This year, some of our commercials to be used will incorporate a composition which requires that all stations using the material be licensed by ASCAP.

We have checked your station listing in the current STANDARD RATE & DATA catalog. Nowhere in your listing is information contained to indicate whether your station is licensed by ASCAP.

Please indicate on the enclosed copy of this letter whether or not you have an ASCAP license, and return the information to this office promptly. Your attention to this matter will be greatly appreciated.

Repeating, your station will not be eligible to be considered for our summer spot scheduling unless you do have an ASCAP license.

Sincerely,

[Janice Meredith (Miss)]
Broadcast Traffic

DO HAVE ASCAP LICENSE.....

DO NOT HAVE ASCAP LICENSE.....

SIGNED.....STATION.....

CAPACITY.....DATE.....

No. 20073

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

OIL BASE, INC.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE

TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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ON PETITION FOR REVIEW OF THE DECISION OF THE

TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (I-R. 26-51)[1] are not officially reported.

JURISDICTION

This petition for review (I-R. 59-61) involves federal income tax for the fiscal year ended September 30, 1959. On March 8, 1963, the Commissioner of Internal Revenue mailed to the taxpayer notice of deficiency in the amount of $51,718.66. (I-R. 1.) Within ninety

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[1] "I-R." references are to Volume I of the reproduced record.

days thereafter, on June 4, 1963, the taxpayer filed a petition with the Tax Court for a redetermination of the deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1-7.) The decision of the Tax Court was entered January 12, 1965. (I-R. 58.) The case is brought to this Court by a petition for review filed March 30, 1965 (I-R. 59), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

Whether the Tax Court was correct in holding that the Commissioner properly included in taxpayer's income, under the provisions of Section 482 of the Internal Revenue Code of 1954, a portion of the commissions paid and discounts allowed to taxpayer's wholly owned foreign subsidiary.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and Regulations involved are set out in the Appendix, infra.

STATEMENT

Taxpayer is, and has been since prior to 1946, engaged in the business of manufacturing and selling oil base drilling fluid and related products to the oil drilling industry. Since such time, taxpayer has been selling its products in certain foreign countries where oil drilling activity was being conducted. (I-R. 27.)

Taxpayer's principal product is an oil base drilling fluid known as "Black Magic." Black Magic is a specialized product for use in the oil drilling industry which possesses certain qualities not found in water base drilling fluids. It produces highly desirable results in certain specialized oil well drilling situations. The product is more expensive than water base drilling fluids, is dirty, and is disagreeable to work with. For this reason taxpayer considers it necessary to direct its selling efforts to all levels of oil drilling personnel ranging from top level executives of the oil company down to the drilling crews. Generally, it requires more than one contract to result in a sale of taxpayer's product. (I-R. 27-28.)

Servicing the use of taxpayer's products after a sale is also an important feature of taxpayer's business. Taxpayer maintains a staff of service engineers whose main duty is to service and supervise the use of taxpayer's products by its customers. All of taxpayer's sales and service engineers are trained in the use of taxpayer's products and taxpayer's top executives are likewise trained. (I-R. 28.)

Prior to October 1, 1955, taxpayer's foreign sales had been accomplished through various independent sales representatives. (I-R. 28.) On or about October 1, 1955, taxpayer and Baritina de Venezuela, S.A., a Venezuelan corporation of Caracas, Venezuela (hereinafter referred to as Baritina), executed an agreement pursuant to which Baritina was to act as the exclusive sales

representative for taxpayer's products in the country of Venezuela. This agreement provided that Baritina would diligently and faithfully prosecute the sale of taxpayer's products, would forward to taxpayer all orders to be shipped by taxpayer directly to Baritina's customers, would pay its own costs and expenses, and would maintain at its own expense an adequate and competent staff of sales engineers in connection with the selling and servicing of taxpayer's products. It further provided that Baritina would send one or more persons to taxpayer's Compton, California, plant for instruction in the use and sale of taxpayer's products and that Baritina would not sell or attempt to sell any product similar to taxpayer's products without taxpayer's consent. The agreement also contained other general provisions with respect to liabilities of the parties, claims, and price of merchandise. (I-R. 28-29.) In addition, the contract contained the following provision with respect to Baritina's commissions and discounts (I-R. 29-30):

> 8. First Party (OIL BASE, INC.) agrees to pay to Second Party [Baritina] as commissions upon merchandise shipped directly by First Party to the customers within Second Party's territory, as hereinafter set forth under heading (a) of this paragraph contained; First Party does further agree to allow Second Party discounts from its list price of merchandise, hereinafter listed as

may be purchased by Second Party from First Party for resale and stocked or warehoused by it, as hereinafter set forth under headings (b) and (c) of this paragraph contained:

	(a) (commission)	(b) Net 90 days from date of invoice (discount)	(c) Net 30 days from date of invoice (discount)
OB Wate	15%	17 1/2%	20%
Filter Presses	15%	17 1/2%	20%
Chemical "V"	15%	17 1/2%	20%
OB Zero	15%	17 1/2%	20%
Mix Fix	15%	17 1/2%	20%
Additive "E"	15%	17 1/2%	20%
Sacked Black Magic	20%	22 1/2%	25%
OB Gel	20%	22 1/2%	25%
OB Gen	20%	22 1/2%	25%
White Magic	20%	22 1/2%	25%
Economagic	20%	22 1/2%	25%
Peptomagic	20%	22 1/2%	25%
No-Glo Oil	20%	22 1/2%	25%
No-Glo Thread Lubricant	20%	22 1/2%	25%
Special Additive 58	20%	22 1/2%	25%
Formaseal	20%	22 1/2%	25%
Mud Guns	20%	22 1/2%	25%
Well Wash	20%	22 1/2%	25%
Chemical "W"	20%	22 1/2%	25%
Black Magic Premix	20%	22 1/2%	25%
Hand Cleaner	20%	22 1/2%	25%

On or about December 1, 1955, taxpayer and Baritina executed a document entitled "Supplemental Agreement" pursuant to which the country of Colombia was added to the territory for which Baritina was to be the exclusive representative of taxpayer's products. This supplemental agreement further provided that A.Z. Export, S. A., was to be named as exclusive subagent and distributor of taxpayer's products in the Republic of Colombia. (I-R. 30.)

During the time that Baritina was representing taxpayer, taxpayer furnished Baritina one of its own experienced engineers who went to Venezuela and became employed by Baritina. This engineer, while employed by Baritina, worked primarily on sales of taxpayer's products. (I-R. 31.)

The agreement between taxpayer and Baritina remained in force through September 30, 1957. After this date, and during the period of time in which Baritina and taxpayer were negotiating in an effort to reach a new agreement, Baritina continued to sell taxpayer's products even though no written contract between the two parties was in effect. (I-R. 30-31.)

After the termination of the agreement between taxpayer and Baritina on September 30, 1957, the two companies negotiated for renewal and modification of the agreement. These negotiations consisted of correspondence between the two companies and one personal conference between representatives of taxpayer and a representative of Baritina. In these negotiations, taxpayer's representatives took the position that since 40 per cent of Baritina's stock had been acquired by National Lead Company (who operated a division called the Baroid Division which was a direct competitor of taxpayer) taxpayer should have protection with respect to the time period of the contract and the quantity of inventory carried by Baritina.[2/] In addition, taxpayer wanted

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2/ Taxpayer wanted the contract to be for a term of five years and for Baritina to maintain a minimum inventory of $100,000. (I-R. 33.)

Baritina to erect a premix plant in order that taxpayer's products might be shipped in a dry state to Venezuela and mixed in liquid form in that country. Taxpayer also wanted Baritina to agree to send four or more persons to its plant in Compton for training. (I-R. 31-32.)

During the course of negotiations, Baritina requested higher commissions and discounts. At the personal conference between representatives of taxpayer and of Baritina, taxpayer's representatives received the impression that the representative of Baritina had authority to agree to a contract on behalf of Baritina and at the conclusions of the conference were under the impression that agreement had been reached between the two companies regarding the provisions of a new contract. In accordance with this understanding, taxpayer's president, under date of March 10, 1958, submitted to the general manager of Baritina a proposed new contract to be entered into between the two companies as of April 1, 1958, which proposed contract was understood to be in accordance with the agreement reached at the personal conference. (I-R. 32.) The proposed agreement submitted by taxpayer's president to Baritina with a letter, dated March 10, 1958, was for a period of one year and contained among

its provisions the following (I-R. 32-34):

(1) Baritina would agree to maintain at its own expense an adequate and competent staff of sales engineers in connection with the selling and servicing of Oil Base's products. In connection with the foregoing, Baritina would agree to send four or more persons to Oil Base's plant at Compton, California, within a period of 120 days from the date of the contract for instruction in the use, and sales procedures adopted by Oil Base in connection with the consumer use and sale of its products. All transportation, living, maintenance, and salary expenses of and for such persons were to be borne and paid by Baritina. Baritina, however, had the option, in lieu of sending the four persons for training at Oil Base's plant at Compton, California, to request Oil Base to send one of its trained engineers to Venezuela to train and instruct the four persons as sales engineers, all expenses of this representative of Oil Base, including salary, to be borne and paid by Baritina.

(2) Baritina would agree to maintain at all times during the existence of the agreement a minimum stock of Oil Base material in certain

described quantities which had a minimum purchase price of $100,000.

(3) In consideration of Oil Base paying certain commissions which had accrued to Baritina during the period when no contract between the two companies was in existence and which were in the amount of $15,000, Baritina would agree to erect immediately at its sole expense a premix plant in accord with blueprints furnished to Baritina by Oil Base. This premix plant was to be erected at Las Morochas, Venezuela, for use in the processing, storage and sale of Oil Base products.

(4) Baritina would agree to maintain two trained sales engineers in the Republic of Colombia at all times during the existence of the agreement.

The commissions and discounts set forth in the proposed agreement were identical to those which had been contained in the prior agreement between taxpayer and Baritina. The term of one year in the contract was in accordance with information which the assistant general manager of Baritina had given to representatives of taxpayer, subsequent to the personal conference between representatives of the two companies, to the effect that the general manager of Baroid Sales Division of National Lead Company would agree to a one-year term only in the contract. (I-R. 34.)

Subsequent to the submission of the proposed contract to Baritina, further correspondence took place between representatives of taxpayer and of Baritina in which the representatives of Baritina stated that Baritina could not agree to the new provisions of the proposed contract which required Baritina to keep a minimum inventory and to construct a premix plant in Venezuela. The estimated cost of the construction of the premix plant was approximately $25,000. (I-R. 34.)

In a letter, dated March 17, 1958, from the assistant general manager of Baritina to taxpayer's president discussing the proposed new contract, the following statement was made (I-R. 34-35):

> We are more than willing to continue on the basis of the old contract, making whatever new arrangements within reason which you feel are necessary in Columbia [sic]. This would mean putting at least one permanent sales and service representative in Bogota. In Venezuela, we must be clear in stating that we cannot agree to building a Mixing Plant or maintaining inventories at the present time.
>
> May we hope that you can see your way clear to extend the old contract or a modified form of the new contract excluding those portions commented on in the preceding paragraphs.

At the time the negotiations were being carried on with respect to the new contract between taxpayer and Baritina, the latter company was maintaining in Venezuela an inventory of taxpayer's products in the amount of approximately $85,000. (I-R. 35.)

The proposed new contract between taxpayer and Baritina was never executed and negotiations were terminated in April of 1958. (I-R. 35.)

After termination of negotiations between taxpayer and Baritina, taxpayer's management gave consideration to the best method of marketing taxpayer's products in foreign countries. After consulting counsel in Los Angeles, California, and in Venezuela, taxpayer's board of directors decided to form a wholly-owned Venezuelan corporation to act as taxpayer's sales representative in foreign countries. On or about July 13, 1958, taxpayer caused the formation of Oil Base de Venezuela, C.A., a Venezuelan corporation (hereinafter referred to Obvenca) as a wholly-owned subsidiary of taxpayer. Obvenca was organized with a paid-in capital of $6,000 and at no time during the fiscal year ending September 30, 1959, was this paid-in capital increased. (I-R. 35.)

On or about June 20, 1958, taxpayer and Obvenca executed an agreement pursuant to which Obvenca was to act as taxpayer's exclusive sales representative for the sale of taxpayer's products in all countries of the world except for the United States and the provinces and dominions of Canada. (I-R. 35-36.)

Section 8 of this agreement provided as follows (I-R. 36):

> 8. O.B.I. agrees to pay O.B. Ven., as commissions upon merchandise shipped directly by O.B.I. from any of its plants or warehouses located in the United States of America to a customer located within O.B. Ven.'s territory, such sum as represents twenty per cent (20%) of the net invoice billings of said sales, exclusive of transportation, packaging, insurance, and taxes, of those products of O.B.I. known as OB Wate, Filter Presses, Additive "V", OB Zero, MixFix, Additive "X" and Additive "E"; and such sum as will represent fourty per cent (40%) of the net invoice billings of sales, exclusive of transportation, packaging, insurance and taxes, of all of O.B.I.'s products. O.B.I. does further agree to allow O.B. Ven. discounts of twenty per cent (20%) from its established export list price of its products, exclusive of freight, taxes and special charges for export crating, known as OB Wate, Filter Presses, Additive "V", OB Zero, MixFix, Additive "X" and Additive "E"; and discounts of forty per cent (40%) from its established list price, exclusive of freight, taxes and special charges for export crating, on all other of O.B.I.'s products. If such commissions are due O.B. Ven. because of direct purchases made from O.B.I. by customers operating in O.B. Ven.'s territory as aforedescribed, such commissions shall be determined and paid on the 20th day of the month next succeeding the month in which payment is made to O.B.I. by such customers.

The agreement between taxpayer and Obvenca was for the period commencing June 20, 1958 and ending January 1, 1959. (I-R. 36.) This agreement was extended for an additional year to December 31, 1959. (I-R. 36.) The agreement between taxpayer and Obvenca did not require Obvenca to maintain a minimum inventory, to erect a premix plant, to send four sales engineers for training at taxpayer's plant, or to maintain two sales engineers in Colombia. (I-R. 36-37.)

On July 1, 1958, Obvenca entered into a written agreement with M. R. Vollmer and M. L. Cooper who are referred to in the agreement as Volco. Under this agreement Volco was designated as the exclusive sales representative of taxpayer's products in the country of Colombia. Under the provisions of this agreement, Volco was to receive a ten per cent commission on products shipped directly by Obvenca to customers within the country of Colombia. This agreement obligated Volco to maintain two trained sales engineers in the Republic of Colombia at all times during the existence of the agreement. (I-R. 37.)

By assignment agreement, dated November 24, 1958, the agreement between Obvenca and Volco was assigned to Volco, Inc., a Panamanian corporation. Volco, Inc., was a corporation formed by M. R. Vollmer and M. L. Cooper. The assignment was agreed to by Obvenca. Prior to July 1, 1958, M. R. Vollmer and M. L. Cooper were representatives of an agent of Baritina in the Republic of Colombia and in that capacity sold and serviced taxpayer's products in Colombia. (I-R. 37.)

On October 1, 1958, Obvenca entered into an agreement with Servicios Petroleros, S.A., a Peruvian corporation (hereinafter referred to as Servicios), under which Servicios was designated as the exclusive sales representative of taxpayer's products in the country of Peru. This contract provided for the same commissions and discounts which had been provided for in taxpayer's contract with Baritina and in the proposed contract of April 1, 1958, between taxpayer and Baritina. (I-R. 37-38.)

On October 1, 1958, Obvenca entered into an agreement with Gene L. Towle, under which Towle was designated as exclusive sales representative of taxpayer's products in Mexico. This contract provided for the same commissions and discounts which had been provided for in taxpayer's contract with Baritina and in the proposed contract of April 1, 1958, between taxpayer and Baritina. (I-R. 38.)

Contracts between Obvenca and its three subagents were each signed by the president of Obvenca, who was also taxpayer's president. (I-R. 38.)

The agreement between Obvenca and Volco, Inc., covering the period beginning July 1, 1959 and ending September 30, 1960, provided for commissions to bc paid and discounts to be allowed to Volco, Inc., in the same amounts as had been allowed by taxpayer to Baritina and as were being then allowed to Servicios and Gene Towle. (I-R. 38.)

On October 1, 1958, taxpayer and Milwhite Mud Sales Company, Ltd. (hereinafter referred to as Milwhite), entered into a contract under which Milwhite was designated as exclusive sales representative for taxpayer's products in the provinces of Alberta and Saskatchewan, Canada. Commissions and discounts allowed to Milwhite under this contract were exactly the same as those which had been allowed by taxpayer to Baritina and which were set forth in the proposed contract of April 1, 1958 between

taxpayer and Baritina. Taxpayer's agreement with Milwhite was for a one-year period and was extended for an additional period to October 1, 1960. (I-R. 38-39.)

During the period beginning June 20, 1958, and continuing until about December 20, 1958, Richard Newman was the only full-time employee of Obvenca. Newman was stationed in Puerto La Cruz, Venezuela. Prior to being employed by Obvenca, Newman had been employed as a sales engineer by Baritina in Venezuela and in that capacity had sold and serviced taxpayer's products. Prior to becoming employed by Baritina, Newman had been employed as a sales engineer for taxpayer. Newman severed his connection with Obvenca about December 20, 1958. A period of approximately two weeks expired before Newman's replacement arrived in Puerto La Cruz, Venezuela. (I-R. 39.)

Newman's replacement was a man named White who had been employed by taxpayer prior to becoming employed by Obvenca. White took over his duties with Obvenca shortly after January 1, 1959. White was the only full-time employee of Obvenca from the time he became so employed throughout the balance of the fiscal year ending September 30, 1959. Newman, while being employed by Obvenca, and White, when he replaced Newman, served as sales engineer, service engineer, and general manager of Obvenca. (I-R. 39.)

Shortly after Obvenca was organized, a public accountant located in Venezuela was paid $75 to open a set of books for the newly organized corporation. It was agreed that this accountant would be paid for bookkeeping service by the corporation, and with no additional charge would permit Obvenca to use his post office box number in Puerto La Cruz and space in his office for the general manager of Obvenca to occupy from time to time. This accountant had other clients besides Obvenca. It was agreed that the payment for services, without any additional charge for the post office box and the furnishing of an office, would be approximately $150 per month. The accountant's practice, with whom Obvenca made the arrangements, was purchased around the first of May, 1959. The accounting firm which purchased the practice continued the same arrangement with Obvenca. (I-R. 39-40.)

During the fiscal year ended September 30, 1959, the president and vice president of taxpayer, who were also the president and executive vice president of Obvenca, made a trip to Venezuela, and during the course of the trip visited Mexico and Colombia. In the business dealings conducted in Venezuela, they represented themselves as officers of Obvenca. During some of the trip, the two officers were accompanied by Newman, the manager of Obvenca. On the trip in Colombia, taxpayer's two officers represented themselves as officers of Obvenca. They were accompanied by the Colombian agents who handled the taxpayer's

products. In accordance with the agreement between Obvenca and taxpayer, each of the companies bore one-half of the expense of the trip made by these officers to Venezuela, Colombia and Mexico. (I-R. 40.)

It had been taxpayer's consistent practice during the years it was marketing its products in foreign countries to send employees to the countries in which the products were being sold for the purpose of assisting its sales representatives in servicing the use of its products. Taxpayer's assistant sales manager was usually the representative sent to Venezuela and Colombia and while on such trips he went to the site where taxpayer's products were being used and serviced the use of taxpayer's products. The expense of these trips was borne solely by taxpayer. (I-R. 41.)

As of September 30, 1958, Obvenca had inventory of a value of $21,809 stored at a leased warehouse in Puerto La Cruz, Venezuela; and as of September 30, 1959, it had inventory stored in this warehouse of a value of $27,764. As of these same dates Obvenca owned office equipment which had a cost of $758 and an automobile which had a cost of $3,611; and as of September 30, 1959, Obvenca owned the furniture for a manager's house which had a cost of $1,200. (I-R. 41.)

During the fiscal period ended September 30, 1958 and the fiscal year ended September 30, 1959, Obvenca leased a warehouse in Puerto La Cruz for Bs. 500 per month. During the fiscal year 1959 it required three and one-third Bolivars (Bs.) to equal one United States dollar. (I-R. 41.)

During the fiscal period ended September 30, 1958 and the fiscal year ended September 30, 1959, Obvenca leased a manager's house located at Phillips Camp at San Roque, Venezuela, for a monthly rental of Bs. 800 and a house located at Nalco Camp, Anaco, for a monthly rental of Bs. 1,000. (I-R. 41-42.)

For the fiscal year ended September 30, 1959, Obvenca was charged (for services rendered) $3,136.33 and $1,055.33 of the salaries paid by taxpayer to its president and vice president, respectively, who were also the president and executive vice president of Obvenca. In addition, taxpayer's treasurer also rendered services for Obvenca and for services rendered by the individual who was taxpayer's treasurer until July, 1959, Obvenca was charged $275.40 and for services rendered by the individual who became taxpayer's treasurer on July 1, 1959, Obvenca was charged $117.63 for the fiscal year ended September 30, 1959. (I-R. 42.)

Obvenca had income and retained earnings of $18,208 for the three and a half-month period ended September 30, 1958, a net income of $81,031 for the fiscal year ended September 30, 1959, and retained earnings of $99,239 for the fiscal year ended September 30, 1959. Taxpayer's direct profit from sales for its fiscal years ending September 30, 1956, 1957, 1958 and 1959 expressed as a percentage of total gross sales, the direct profit from domestic sales expressed as a percentage of those sales, and export sales expressed as a percentage of such sales are as follows (I-R. 42-43):

	Fiscal Years Ended September 30			
	1956	1957	1958	1959
	Percent			
Total	24.7	21.6	32.0	23.0
Domestic	22.4	14.0	21.2	22.5
Export	34.6	30.1	45.6	23.9

Direct profit used in computing these percentages represents the profit after deducting from gross sales all discounts and commissions allowed; manufacturing cost of goods sold; any patent royalties paid with respect to the goods sold; and the direct selling expenses including salesmen's expenses, salaries, and entertainment expenses. (I-R. 43.)

Throughout the fiscal year ended September 30, 1959, taxpayer owned all the outstanding capital stock of Obvenca. (I-R. 43.)

Each of the officers and directors of Obvenca was also an officer of taxpayer. (I-R. 43.)

In May of 1958, which was prior to the organization of Obvenca, taxpayer's representatives made a trip to Venezuela and Colombia at which time he discussed with Newman, who was then employed by Baritina, employment in Venezuela by taxpayer's proposed subsidiary. He also discussed with Vollmer and Cooper their serving as sales representatives for taxpayer's products in Colombia. At that time Vollmer and Cooper were employees of a subagent who was a distributor of taxpayer's products in Colombia on behalf of Baritina. (I-R. 43.)

Certain officers of taxpayer, who were also officers of Obvenca, carried on extensive correspondence on behalf of Obvenca from taxpayer's office in Compton, California. Although the letterhead of Obvenca was used in this correspondence, such correspondence was actually written in Compton, California, by secretaries who were full-time employees of taxpayer. (I-R. 43-44.)

During the fiscal year ended September 30, 1959, between 80 and 85 per cent of the sales of taxpayer's products in the Republic of Colombia were made to Texas Petroleum Company in Colombia. Some of the sales resulted from orders sent by Texas Petroleum Company's New York City office to taxpayer in Compton, California, with directions that the order be shipped to the Texas Petroleum Company in Colombia. Taxpayer would then prepare documents showing taxpayer as the shipper and Texas Petroleum Company, Colombian Division, as the consignee and purchaser. (I-R. 44.)

Taxpayer on its federal income tax return for its fiscal year ended September 30, 1959 reported taxable income of $20,457.80. (I-R. 44.)

The Commissioner of Internal Revenue in his notice of deficiency, in addition to making adjustments which though originally in issue in the petition in this case have been disposed of by agreement of the parties, increased taxpayer's reported income by the amount of $106,699.14 designated as "Sales increased" and made the following explanation of this adjustment (I-R. 44-45):

> It is determined that commissions paid and discounts allowed to your controlled foreign subsidiary, Oil Base de Venezuela, C.A. were excessive in amount and had the effect of improperly shifting income from you to your controlled foreign subsidiary, thereby

> distorting your income and the income of your subsidiary. Furthermore, sales commissions were paid to Oil Base de Venezuela on certain sales occurring outside of Venezuela which were, in substance, your sales and on these sales no commissions are being allowed under this determination. In determining the proper amount allowable as commissions and discounts paid to Oil Base de Venezuela, C.A. where some amount is properly allowable, the determination has been based on arm's length negotiated rates between yourselves and uncontrolled parties on identical goods and services. This issue involves application of sections 61 and 482 of the Internal Revenue Code of 1954.

The Tax Court held that the record evidence was such as to indicate that a fair and reasonable commission and discount to be allowed Obvenca on the sales it made of taxpayer's products in Venezuela was the amount of commission and discount that had been allowed to Baritina, was proposed in the new contract to be allowed to Baritina, and which was allowed to taxpayer's Canadian representative and to Obvenca's various subagents. (I-R. 50.)

As for the sales made in Colombia, Mexico and Peru, the Tax Court found taxpayer to have shown no evidence of any services being performed by Obvenca which would entitle it to a profit on these sales. Accordingly, the Tax Court held that the rates of commissions and discounts allowed by the Commissioner with respect to taxpayer's Venezuelan sales were also proper with respect to all sales of taxpayer's products in Colombia, Mexico

and Peru made through Obvenca during the fiscal year ended September 30, 1959, in computing the amount of the commissions paid by taxpayer to its subsidiary which were properly deductible by taxpayer in determining its taxable income for its fiscal year 1959. (I-R. 51.)

SUMMARY OF ARGUMENT

Section 482 of the Internal Revenue Code of 1954 authorizes the Commissioner, in any case of two or more businesses controlled by the same interests, to distribute, apportion or allocate gross income, deductions, credits or allowances between such businesses if he determines that it is necessary in order to prevent evasion of taxes or clearly to reflect income. The purpose of this section is to place controlled taxpayers on a parity with uncontrolled taxpayers by determining the true net income of a controlled taxpayer through application of the standard of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

The commissions paid and discounts allowed by the taxpayer to its wholly owned subsidiary were far in excess of those which would have been allowed had the contract been entered into between the taxpayer and an uncontrolled organization; and were in fact far in excess of commissions and discounts made available to an independent party who became taxpayer's Canadian representative shortly after taxpayer's contract with its subsidiary went into effect.

The Commissioner contends that the proper criteria to be used here in allocating income to the taxpayer were those rates of commissions and discounts which taxpayer allowed to its Canadian representatives, which taxpayer had allowed to its Venezuelan representatives prior to taxpayer's contract with its subsidiary and which were allowed by taxpayer's subsidiary to its contractual subagents.

The allocation so made by the Commissioner may be overturned only if shown by the taxpayer to have been arbitrary, capricious or unreasonable. The determination as to whether or not the Commissioner has exceeded or abused his discretion is factual in nature and should not be set aside unless clearly erroneous.

ARGUMENT

I

SECTION 482 IS A GRANT OF ADMINISTRATIVE DISCRETION TO ALLOCATE DEDUCTIONS AMONG CONTROLLED BUSINESSES, THE EXERCISE OF WHICH MUST BE SUSTAINED IN THE ABSENCE OF CLEAR ABUSE

Section 482 of the Internal Revenue Code of 1954 (Appendix, infra) provides in pertinent part, that in any case of two or more businesses controlled by the same interests, the Secretary of the Treasury or his delegate may distribute, apportion or allocate gross income, deductions, credits, or allowances between such businesses if he determines that it is necessary

in order to prevent evasion of taxes or clearly to reflect their income. Section 482 is substantially the same as its predecessor, Section 45 of the Internal Revenue Code of 1939, which has its origin, as explained in National Securities Corp. v. Commissioner, 137 F. 2d 600, 602 (C.A. 3d), certiorari denied, 320 U.S. 794, in Section 240 of the Revenue Act of 1926, c. 27, 44 Stat. 9, which authorized affiliated corporations to file consolidated returns. Subsection (f) of Section 240 authorized the Commissioner of Internal Revenue "in any case of two or more related trades or businesses* * *owned or controlled directly by the same interest to consolidate their accounts if necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses." The Revenue Act of 1928, c. 852, 45 Stat. 791, eliminated the right of affiliated corporations to file consolidated returns and in the place of Section 240(f), Congress added Section 45 which, as the report of the House Ways and Means Committee pointed out, was based upon Section 240(f) of the 1926 Act "broadened considerably in order to afford adequate protection to the Government made necessary by the elimination of the consolidated returns provision of the 1926 Act." H. Rep. No. 2, 70th Cong., 1st Sess., p. 16 (1939-1 Cum. Bull. (Part 2) 384, 395).

The purpose of Section 482 is, as explained by Section 1.482-1(b)(1), Treasury Regulations on Income Tax (Appendix, infra), to place controlled taxpayers on a tax parity with uncontrolled taxpayers by determining the true net income of a controlled taxpayer through application of the standard of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. The authority to determine true net income extends to any case in which either by inadvertence or design, the taxable net income is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. Commissioner v. Chelsea Products, 197 F. 2d 620, 623 (C.A. 3d). That is, whenever the lack of an arm's length relationship produces a different economic result from that which would ensue in the case of two uncontrolled taxpayers dealing at arm's length, the Commissioner is authorized to allocate gross income and deductions. Commissioner v. Chelsea Products, supra; Aiken Drive-In Theatre Corp. v. United States, 281 F. 2d 7 (C.A. 4th); Spicer Theatre, Inc. v. Commissioner, 346 F. 2d 704 (C.A. 6th); Simon J. Murphy Co. v. Commissioner, 231 F. 2d 639 (C.A. 6th).

Litigation under the statute has shown that Section 482 has been applied to circumstances which involve an improper manipulation of financial accounts, an improper juggling of accounts

between the related businesses, an improper "milking" of one business for the benefit of the other or some similar abuse of proper financial accounting which was made possible by the control of the two businesses by the same interests. Spicer Theatre, Inc. v. Commissioner, supra; Simon J. Murphy Co. v. Commissioner, supra; Asiatic Petroleum Co. v. Commissioner, 79 F. 2d 234 (C.A. 2d), certiorari denied, 296 U.S. 645; Rooney v. United States, 305 F. 2d 681 (C.A. 9th).

Section 482 attempts to recognize the normal tax effect of bona fide business transactions between separate organizations even though controlled by the same interest while at the same time enabling the Commissioner to change the bookkeeping effect of a transaction between controlled taxpayers when, by reason of the relationship, they arbitrarily or improperly shift income or deductions from one organization to another. Simon J. Murphy Co. v. Commissioner, supra. It is well settled that the dominant purpose of the revenue law is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid. Helvering v. Horst, 311 U.S. 112, 119; Shaw Construction Co. v. Commissioner, 323 F. 2d 316, 320 (C.A. 9th).

By virtue of Section 482, the Commissioner is vested with broad discretion and a determination made by the Commissioner should be overturned only if shown by the taxpayer to have been arbitrary or unreasonable. Helvering v. Taylor, 293 U.S. 507; G.U.R. v. Commissioner, 117 F. 2d 187 (C.A. 7th); Ballentine Motor Co. v.

Commissioner, 321 F. 2d 796 (C.A. 4th); Campbell County State Bank, Inc. of Herreid, S.D. v. Commissioner, 311 F. 2d 374 (C.A. 8th); Spicer Theatre, Inc. v. Commissioner, supra; National Securities Corp. v. Commissioner, supra; Grenada Industries, Inc. v. Commissioner, 202 F. 2d 873 (C.A. 5th), certiorari denied, 346 U.S. 918.

A determination as to whether or not the Commissioner has exceeded or abused his discretion turns upon questions of fact and as such is subject to limited review. Ballentine Motor Co. v. Commissioner, supra; Commissioner v. Chelsea Products, supra; Hall v. Commissioner, 294 F. 2d 82 (C.A. 5th). In addition, the question whether the income was earned by taxpayer or by its subsidiary is, at least primarily, the determination of a question of fact (Ballentine Motor Co. v. Commissioner, supra; Campbell County State Bank, Inc. of Herreid, S.D. v. Commissioner, supra; Advance Machinery Exch. v. Commissioner, 196 F. 2d 1006 (C.A. 2d), certiorari denied, 344 U.S. 835) and in order to persuade this Court to reverse the findings of the Tax Court, taxpayer must show that such findings were clearly erroneous (Commissioner v. Duberstein, 363 U.S. 278).

Under the facts and circumstances of the instant case, the findings and conclusions of the Tax Court to the effect that the Commissioner did not abuse his discretion or act arbitrarily, capriciously, or unreasonably in invoking and applying Section 482 are satisfactorily supported by the record evidence and should not be disturbed.

II

THE TAX COURT CORRECTLY HELD THAT THE COMMISSIONER PROPERLY INCLUDED IN TAXPAYER'S INCOME, UNDER THE PROVISIONS OF SECTION 482 OF THE INTERNAL REVENUE CODE OF 1954, A PORTION OF THE COMMISSIONS PAID AND DISCOUNTS ALLOWED TO TAXPAYER'S WHOLLY OWNED FOREIGN SUBSIDIARY

The Commissioner is not here taking issue with the right of a parent and a subsidiary company to contract with each other so long as the contract is one which they would have entered into with an uncontrolled organization. The facts here, however, fully support the determination of the Commissioner that the commissions paid and the discounts allowed to the subsidiary were far in excess of those which would have been granted had the contract been entered into between the taxpayer and an uncontrolled organization; which commissions and discounts were in fact far in excess of those commissions and discounts made available to an independent party who became taxpayer's Canadian representative shortly after the OBI-Obvenca contract went into effect.

Prior to the contract with Obvenca, taxpayer had entered into a contract with Baritina for the sale and service of its products in Venezuela and Colombia. (I-R. 28, 30.) The commission to be allowed to Baritina on the bulk of the products which it sold was to be 20 per cent with a discount on the same products being 25 per cent. (I-R. 30.) This contract expired in 1957 and negotiations for its renewal began then. (I-R. 30.) Taxpayer, for various

business reasons, felt that additional requirements should be placed upon Baritina under the new contract. The additional requirements included locating two sales engineers in Colombia (I-R. 34), having two additional sales engineers in Venezuela (I-R. 32), having a minimum inventory of taxpayer's stock in the amount of $100,000 (I-R. 33),[3] erecting a premix plant in the Maracaibo area (I-R. 33)[4] and entering into a five-year contract instead of one year (II-R. 45).[5] Taxpayer, however, did not feel that a higher commission or discount rate should be allowed to Baritina even in light of the additional burden which taxpayer was asking Baritina to carry. For, taxpayer's president stated at the trial that if Baritina sold taxpayer's products properly, Baritina could make an adequate profit on the commissions and discounts presently existing. (II-R. 48.)

A tentative agreement was reached as to all the proposed points of the contract with the exception of the five-year term. (I-R. 32-34.) Somewhat later, Baritina notified taxpayer that it could not agree to the requirements of a minimum inventory or the construction of a premix plant because of local and international developments

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3/ Baritina at that time had approximately $85,000 of inventory on hand. (I-R. 35.)

4/ The estimated construction cost of the premix plant was approximately $25,000. (I-R. 34.)

5/ "II-R." references are to Volume II of the reproduced record.

which affected oil production. Baritina did, however, express willingness to continue on the basis of the discounts and commissions as set forth in the old contract (I-R. 34-35) and stated that "our association in the past has been mutually profitable, and can see no reason why things should not continue to be so" (Ex. 4-d, p. 11).

Contract negotiations were discontinued with no agreement having been reached. Taxpayer then decided to organize Obvenca as a foreign subsidiary. Accordingly, Obvenca was organized with a paid-in capital stock of only $6,000. (I-R. 35.)

George Miller, as president of taxpayer and of Obvenca, signed the contract between taxpayer and Obvenca. This contract (Ex. 6-f) did not contain any of the additional requirements which had appeared in the contract offered to Baritina by taxpayer. That is, Obvenca was not required to maintain a minimum inventory, erect a premix plant or to have a set number of sales engineers on its staff. Moreover, the contract was to be for a period of only six months. (I-R. 39-40.) However, in spite of the lack of the above requirements, taxpayer agreed to pay Obvenca a 40 per cent commission on those items which constituted the bulk of the sale of taxpayer's products instead of the 20 per cent commission offered to Baritina and rather than the 22 1/2 per cent discount offered to Baritina, Obvenca was to receive a 40 per cent discount on the

above products. (I-R. 36.) 6/

Taxpayer attempts to justify the fact that the commissions and discounts offered to Obvenca were about twice the amount it had allowed Baritina by stating that its board of directors considered a number of factors in arriving at the rate of commissions and discounts to be allowed Obvenca. Among the factors which taxpayer stated were considered were that Baritina had represented to taxpayer that they were just about breaking even, that Obvenca would be handling taxpayer's products exclusively whereas Baritina handled non-competing products of many manufactuers and thus had a broader base over which to spread its cost, that Obvenca would be "starting from scratch" whereas Baritina was an established and going concern, the manufacturing cost of the products, the high cost of operating in Venezuela and Colombia, and that it would be necessary for Obvenca to obtain subagents and distributors in various foreign countries. (I-R. 48.)

6/ The full significance of the 40 per cent commission and discount can only be appreciated by a realization that of the total sales of $264,259.47 during the fiscal year in question, a commission of 40 per cent was paid on sales of $261,423.76, while a 20 per cent commission was paid on sales of only $2,835.71. (Ex. 26-P.) Discounts were allowed to Obvenca on sales in the amount of $147,100.48. Forty per cent discounts were allowed on sales of $136,722.50; thirty per cent discounts were allowed on sales of $2,097.50; twenty per cent discounts were allowed on sales of $7,005.75; and sixty per cent discounts were allowed on sales of $1,274.73. (Ex. 27-Q.)

The Commissioner contends and the Tax Court found (I-R. 49) that none of the above-recited factors justified the rate of commissions and discounts allowed to Obvenca. A consideration of each factor will show the findings of the Tax Court to be correct.

First, taxpayer attempted to impose certain additional requirements in the proposed contract with Baritina which were not present in the old contract without offering Baritina a higher rate of commissions or discounts. Thus, it would seem that taxpayer did not believe that Baritina was just about breaking even under the old contract. This is clearly illustrated by the fact that taxpayer's president said that if its products were handled properly by Baritina, Baritina could make an adequate profit under the existing rate of commissions and discount. (II-R. 48.)

Second, Obvenca was a newly-formed corporation with absolutely no experience of doing business in Venezuela, with no established managerial or sales staff, with no office or post office box of its own, with only one full-time employee and was completely without the physical assets necessary to enable it to function as the taxpayer's sales representative in Venezuela or any other foreign country. It was in essence an almost shell-like subsidiary. Yet, from these facts taxpayer contends that Obvenca was entitled to higher commissions and discounts than Baritina which was adequately staffed and equipped to handle taxpayer's products. Such a contention flies in the face of all logic and reason. The

Commissioner contends that under such facts Obvenca was not entitled to higher rates of commissions and discounts than those offered Baritina and that in view of such facts a logical argument could even be made that Obvenca should have been offered lower rates of commissions and discounts than were paid and offered to Baritina.

Third, the fact that the manufacturing costs and selling prices of its products were known to taxpayer does not justify higher commissions and discounts being given to Obvenca than to Baritina. These costs were known at the time negotiations were being had with Baritina and no evidence was introduced to show that these costs were any different during the negotiation period with Baritina than they were when, shortly thereafter, the contract with Obvenca was signed. The only inference that can be drawn is that taxpayer was attempting to shift income to Obvenca.

Fourth, if the costs of operating were high in Venezuela and Colombia they would be as high for Baritina as for Obvenca. Moreover, at the time the contract was entered into with Obvenca, taxpayer was aware of what the costs would be in Colombia as negotiations had already been had with Volco as to its becoming the Colombian representative for Obvenca when Obvenca was formed. Within a few weeks after the OBI-Obvenca contract was formalized, a contract between Obvenca and Volco was entered into. Under the

provisions of this contract, Volco was to receive only a 10 per cent commission on taxpayer's products.[7] (I-R. 37.) Thus, Obvenca's operating costs with regard to sales in Colombia were set and were at a minimal level. Furthermore, Obvenca's manner of operation in Venezuela had been set prior to its incorporation. Arrangements had been made with Richard Newman, a Baritina employee who had handled taxpayer's products, to be Obvenca's sole full-time employee in Venezuela.[8] (I-R. 49.) Thus, taxpayer was well aware of what it was going to cost for Obvenca to operate in Venezuela and Colombia and in the skeletal form in which taxpayer intended Obvenca to operate, the operating costs would be at a minimum

Finally, as to the last factor considered, it was not shown by taxpayer why Obvenca should have any profit on sales made by its subagents as no evidence was introduced to show that Obvenca, as opposed to taxpayer, was responsible for any sales made in any country other than Venezuela.

7/ The contract also required Volco to maintain two sales engineers in the country of Colombia. This is in contrast to the one full-time employee of Obvenca who taxpayer felt was capable of performing all of Obvenca's selling duties alone.

8/ Newman had been employed by taxpayer before going with Baritina to handle taxpayer's products.

Moreover, the contract which taxpayer entered into on October 1, 1958 [9] with Milwhite Mud Sales Company, Ltd. (under which Milwhite was designated as taxpayer's exclusive sales representative for taxpayer's products in the Provinces of Alberta and Saskatchewan, Canada), called for the same rates of commissions and discounts to be paid to Milwhite as were paid to Baritina under the old contract and which were proposed to be paid under the new contract. The Milwhite contract thus clearly indicates that the commissions paid and discounts allowed to Obvenca were greatly in excess of those which would have been agreed upon had taxpayer and Obvenca dealt with each other at arm's length.

Furthermore, on the same day that taxpayer entered into its contract with Milwhite, Obvenca entered into a contract with Servicios Petroleros, S.A., a Peruvian corporation, under which Servicios was designated the exclusive sales representative of taxpayer's products in Peru. This contract provided for the same commissions and discounts which had been provided for in taxpayer's contract with Baritina and in the proposed contract between taxpayer and Baritina. (I-R. 37-38.) Also, on that same day, Obvenca entered into an agreement with Gene L. Towle, under which Towle was designated as the exclusive sales representative of taxpayer's products in Mexico. This contract provided for the

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9/ This was only three months after the OBI-Obvenca contract was formalized.

same commissions and discounts as had been allowed to Baritina and which were contained in the proposed contract between taxpayer and Baritina. (I-R. 38.) These contracts also clearly demonstrate that the commissions and discounts allowed Obvenca by taxpayer were not those which would have been reached by independent parties bargaining at arm's length. Thus, the Commissioner submits that the commissions and discounts allowed by Obvenca to its subagents and by taxpayer to Milwhite were the proper criteria to be applied in reallocating income shifted to Obvenca by taxpayer through the allowance of excessive commissions and discounts.

Through such arbitrary shifting of income and by the absorption of officers' salary expense by taxpayer,[10] Obvenca, with capital of only $6,000 was able to report net income and retained earnings of $18,208 for the three and a half month period ending September 30, 1958, net income of $81,031 for its fiscal year ended September 30, 1959, and retained earnings of $99,239[11] for the fiscal year ended September 30, 1959. (I-R. 42.) Taxpayer, on the other hand, due to such shifting of income and absorption of officers' salary expense was able to report net income of only $20,456.80 for the fiscal year ended September 30, 1959. (Ex. 16-P, Sch. 1.) Thus,

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10/ For the fiscal year ended September 30, 1959, taxpayer had salary expense for its officers in the amount of $93,267.16. (Ex. 16-P, Sch. 3.) Of this amount, Obvenca was charged only $4,584.69 for services rendered by taxpayer's president and vice-president (who were also the president and vice-president respectively of Obvenca) and for the services of taxpayer's treasurers.

11/ The retained earnings should be $99,239 and not $99,259 as found by the Tax Court.

Obvenca, a shell-like subsidiary which had only one full-time employee,[12] which owned assets valued at only $4,369, which had no office or post office box of its own but used that of its accountant, which had capital of only $6,000 and whose correspondence was handled by taxpayer from its Compton, California, office (I-R. 43-44) was able to report net income for the tax year in question in an amount four times as large as that of its parent. This is a classic example of arbitrary income shifting if there ever was one.

The case of Hall v. Commissioner, 294 F. 2d 82 (C.A. 5th) bears out this conclusion. In that case, the taxpayer manufactured equipment for the cementing of oil wells. Taxpayer operated in the United States under a partnership known as the Weatherford Company. Prior to 1947, the selling and servicing of taxpayer's equipment in Venezuela was handled by an unrelated third party who was paid a 20 per cent commission for such activity. In July, 1947, Hall formed a Venezuelan corporation with capital of only $8,000. The Venezulean corporation, known as Spring Company, then entered into an agreement with Hall, whereby Spring was designated as the representative and distributor of Hall's products in foreign countries. Under this contract, Spring was to pay Hall the manufacturer's cost of such product plus 10 per cent. The Commissioner of Internal Revenue determined

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12/ There was even a period of time after Mr. Newman left the employ of Obvenca when taxpayer had no one in Venezuela to represent it.

that an allocation of income under Section 45 of the Internal Revenue Code of 1939 was necessary. Accordingly, the Commissioner required Hall to take into income the full selling price of the items sold to Spring for resale to third parties, less a 20 per cent commission paid to Spring for selling and servicing taxpayer's products. That is, the Commissioner allowed Hall to deduct the same rate of commission which Hall had previously paid to unrelated third parties for the same services. The determination of the Commissioner was upheld by the Tax Court which found taxpayer to have arbitrarily shifted income from the Weatherford Company to Spring. The Tax Court in turn was affirmed by the Fifth Circuit which found (p. 85) that "most of the income which would have been realized by Hall as sole proprietor of the Weatherford Company was shifted to Spring Company." Thus, the Commissioner's reallocation of income on the basis of commissions previously paid to unrelated third parties was upheld. Hall v. Commissioner, supra, therefore supports the determination by the Commissioner that taxpayer should be allowed to deduct only that rate of commissions and discounts which it had paid to Baritina before its contract with Obvenca and which it agreed to pay to Milwhite after the contract with Obvenca was entered into.

Frank v. International Canadian Corp., 308 F. 2d 520 (C.A. 9th), does not support the position of taxpayer. An

examination of the facts of that case quickly reveals its inapplicability here. First, this Court there stated (p. 528):

> We might well find that the Commissioner stipulated himself out of court on this issue. The Pretrial Order states that upon admitted facts (Tr. p. 30) the district court "may find (Tr. p. 34) any one of the following to be the ultimate conclusions of fact and law in this case."
>
> Each of the four alternate ultimate conclusions referred to "a reasonable price and profit" as between the two corporations, or to "a reasonable price." (Emphasis added.)
>
> The Commissioner now departs from the Pretrial Order and urges a standard different from that stipulated to by the parties* * * and different from that used by the district court. This he cannot do.

Secondly, and more important, this Court emphasized the fact that the Commissioner there failed to present evidence which would indicate that the parent favored the subsidiary in its contract with the subsidiary or to establish that the mark-up on the two products which the parent sold to its subsidiary was any different from the mark-up on the sale of the same two products to any other customer. This Court there stated (p. 529):

> The Commissioner only estimated Washington's mark-up on other sales; he does not show Washington's mark-up on the two products which it sold to International to be any different from Washington's mark-up on the sale of the same two products to other customers. Washington sold many other products. The Commissioner presents no record evidence showing the profit margins for Washington's different products. Indeed, the Commissioner cannot show record evidence of these profit margins, for he did not inquire into these matters at the trial.

Polak's Frutal Works, Inc. v. Commissioner, 21 T.C. 953, similarly fails to support the position of taxpayer. The Tax Court there stated (p. 976):

> All probative evidence of record is to the effect that Frutal received from the export entities what would be considered in the trade of which it was a part as fair and reasonable prices for its services. Respondent offers no countervailing evidence. Nor does he say what, in his opinion, would constitute such fair and reasonable price. Rather, he would arbitrarily allocate each year whatever percentages of income of the export entity involved is sufficient to bring Frutal's earnings to approximately the level they held in the years prior to the organization of Export.

In the instant case, however, the record evidence clearly shows that the allocation made by the Commissioner under Section 482 was based upon the actual experience of the taxpayer in dealing with uncontrolled parties both immediately prior to and after taxpayer entered into the contract with Obvenca.

Taxpayer contends (Br. 42-43) that since it retained a slightly higher percentage of direct profit from export sales than from domestic sales, even after allowance of the commissions and discounts to its subsidiary in accordance with their contract, it has established that it retained a reasonable return. Taxpayer, however, introduced no evidence to show that the percentage return retained by taxpayer on domestic sales would represent a reasonable return on its export sales. Taxpayer also fails to point out that during the fiscal year in question, which was the

first full year when the rates being allowed to Obvenca were in effect, taxpayer's percentage return on export sales was the lowest it had been since 1956 and was only 54 per cent of what it had been the year before. (I-R. 46.) Thus, it can be seen that the increase in the rate of commissions paid and deductions allowed by taxpayer to its wholly owned subsidiary over that which it had allowed to a third party had the effect of distorting taxpayer's income from what it would have been had the negotiations between taxpayer and Obvenca been at arm's length.

Finally, taxpayer argues (Br. 47) that the effect of the Tax Court's opinion with regard to those sales of taxpayer's products which were made in Colombia, Peru and Mexico was not only to allow Obvenca no profit on such sales, but to require it to operate at a loss. As to the first part of taxpayer's contention, taxpayer has shown no services performed by Obvenca which would entitle it to a profit on the sales in the above countries. (I-R. 51.) As for the second part of taxpayer's contention, the Tax Court found the contractual subagents of Obvenca to actually be taxpayer's distributors. (I-R. 48.) Accordingly, any expense borne by Obvenca with regard to the sale activities in Colombia, Peru and Mexico was an expense of the taxpayer and no deduction therefore could be claimed by Obvenca. Rather, Obvenca would have to look to taxpayer for reimbursement.

CONCLUSION

For the reasons stated above, the decision of the Tax Court should be affirmed.

Respectfully submitted,

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FEBRUARY, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated:_____ day of _____, 1966.

_____
Attorney

APPENDIX

Internal Revenue Code of 1954:

SEC. 482. ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses.

(26 U.S.C. 1958 ed., Sec. 482.)

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.482-1 Determination of the taxable income of a controlled taxpayer.

(a) Definitions. When used in this section--

(1) The term "organization" includes any organization of any kind, whether it be a sole proprietorship, a partnership, a trust, an estate, an association, or a corporation (as each is defined or understood in the Internal Revenue Code or the regulations thereunder), irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign, whether exempt, whether affiliated, or whether a party to a consolidated return.

(2) The term "trade" or "business" includes any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on.

(3) The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisible or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

(4) The term "controlled taxpayer" means any one or two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.

(5) The terms "group" and "group of controlled taxpayers" mean the organizations, trades, or businesses owned or controlled by the same interests.

(6) The term "true taxable income" means, in the case of a controlled taxpayer, the taxable income (or, as the case may be, any item or element affecting taxable income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, arrangement, or other act) dealt with the other member or members of the group at arm's length. It does not mean the income, the deductions, the credits, the allowances, or the item or element of income, deductions, credits, or allowances, resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, or the interests controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties thereto).

(b) Scope and purpose. (1) The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income from the

property and business of each of the controlled taxpayers. If however, this has not been done, and the taxable incomes are thereby understated, the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

(2) Section 482 and this section apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return. If a controlled taxpayer makes a separate return, the determination is of its true separate taxable income. If a controlled taxpayer is a party to a consolidated return, the true consolidated taxable income of the affiliated group and the true separate taxable income of the controlled taxpayer are determined consistently with the principles of a consolidated return.

(3) Section 482 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the district director to apply such provisions. It is not intended (except in the case of the computation of consolidated taxable income under a consolidated return) to effect in any case such a distribution, apportionment, or allocation of gross income, deductions, credits, or allowances, as would produce a result equivalent to a computation of consolidated taxable income under subchapter A, chapter 6 of the Code.

(c) Application. Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true taxable income of a controlled taxpayer, the district director is not restricted to the case of improper accounting, to

the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

(26 C.F.R., Sec. 1.482-1.)

No. 20071

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BAKER & TAYLOR DRILLING CO.,

Appellant,

vs.

R. W. STAFFORD, Trustee,

Appellee.

Appeal From the District Court of the United States for the Southern District of California, Central Division.

APPELLANT'S OPENING BRIEF.

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Appellee.

APPELLANT'S OPENING BRIEF.

I.

Statement of Pleadings and Facts as to Jurisdiction.

This is an appeal from final judgment of the United States District Court for the Southern District of California, Central Division, in a controversy arising in a Chapter X Bankruptcy proceeding for corporation reorganization.

On June 1, 1963, Tri-State Petroleum, Inc. filed in the United States District Court for the Northern District of Nevada a petition for corporation reorganization under Chapter X of the Bankruptcy Act (U.S.C. Title 11, Chap. X, Secs. 501 *et seq.*) [R. 2 *et seq.*]. On June 24, 1963, an order was entered in the United States District Court for the District of Nevada approving the petition, appointing R. W. Stafford Trustee, ordering reference to Special Master and restraining all persons from commencing or continuing any action or suit against the debtor or Trustee, in any court, for

the purpose of taking possession of or interfering with possession of or enforcing a lien upon any property owned by or in possession of the debtor or Trustee [R. 10 *et seq.*]. On August 10, 1963, the proceeding was transferred to the District Court of the United States for the Southern District of California, Central Division [R. 91 *et seq.*]. On September 4, 1963, Ronald Walker was appointed Referee and Special Master in the proceeding by the United States District Court, Southern District of California, Central Division [R. 298].

On February 19, 1964, R. W. Stafford, Trustee, filed in such proceeding an application for show cause order alleging that the debtor corporation had an interest in oil and gas well and leases located in Hansford County, Texas, among which was alleged to be a gas well located on the SE/4 of Section 2, Block 1, H&GN Ry. Co. Survey, Hansford County, Texas; that J. D. Amend, acting on behalf of himself and the debtor corporation, entered into an oil and gas lease with Phillips Petroleum Company for the drilling of a gas well on said SE/4 of Section 2, and, as evidence of the agreement, J. D. Amend addressed a letter to H. F. Schlittler who was then President of the debtor corporation, the substance of the letter, as set out in the application for show cause order, was that it would confirm an agreement as to a Cleveland gas well on Section 2; that after entering into the lease, a well was drilled capable of producing; that debtor corporation advanced sums of money to assist in defraying expenses of drilling the well; that certain obligations were incurred which have not been satisfied, and that among the creditors claiming a lien upon the well and property were Baker & Taylor Drilling Co. and J. D. Amend; that Baker & Taylor Drilling Co., with offices at Amarillo, Texas, was claiming a lien upon the property in the sum of $27,536.78 by vir-

tue of certain work and drilling operations performed by the company upon the property; that during the drilling of the well and during the month of December, 1962, the debtor corporation paid to Baker & Taylor Drilling Co. the sum of $60,000.00 represented by three checks made payable to Baker & Taylor Drilling Co. for the purpose of applying same upon the drilling operations upon the well, and that it appeared that credit had only been given for the payment of $29,363.00; that for proper administration of the estate the validity and amount of the liens and claims should be determined and that the lien rights of such creditor be transferred to the funds to be received from production and/or sale of the property, so as to permit applicant to operate the properties. Applicant prayed that an order ordering and directing Baker & Taylor Drilling Co., J. D. Amend and other named parties to show cause why they should not be required to establish the amount of their claim and validity of any claimed lien before the court, why any valid lien found to be in existence should not be transferred to the funds received from the operation of the well, why the Trustee should not be permitted to operate the properties and why it should not be determined that each of the creditors is amenable and subject to the restraining order of the court and enjoined from filing or prosecuting any pending litigation against the property described [R. 107 *et seq.*].

On February 19, 1964, Ronald Walker, Referee and Special Master in Bankruptcy, made and entered an order that Baker & Taylor Drilling Co., J. D. Amend and other named parties appear before the court in Los Angeles, California, at a time and hour fixed, and show cause, if any, why they should not be required to establish the amount of their claim, if any, and the validity of any claimed lien upon the property belonging to debtor, including the oil and gas well described in the

application of Trustee; why the creditors should not be required to abide the restraining order of June 24, 1963; why any creditor who had knowingly violated that restraining order should not be certified for contempt; why any lien rights shown to exist should not be transferred to the funds received from the sale or operation of the well [R. 116, 117].

Baker & Taylor Drilling Co., pursuant to the show cause order, filed its plea to the jurisdiction asserting lack of jurisdiction as to subject matter and as to person [R. 141-144] and, subject thereto, its answer asserting that it had entered into a contract with J. D. Amend for the drilling of the well in question, that J. D. Amend became indebted to it for the drilling of the well and that Baker & Taylor Drilling Co. held a lien against the gas well and asserted that lien [R. 145-151]. J. D. Amend filed pleading on February 28, 1964, which he supplemented March 5, 1964 [R. 119, 139].

The Special Master proceeded with hearings on March 24 and 25, 1964 [Rep. Tr. of hearings on order to show cause filed herein as Vol. II of the Record]. The Special Master thereafter heard evidence on July 1 and 2, 1964 [Rep. Tr. of reset hearing on order to show cause filed as Vol. III of the Record].

The Special Master, as Special Master on October 26, 1964, filed in the United States District Court, Southern District of California, Central Division, Findings, Report, Recommendations and Order, subject to approval of the United States District Judge. The Findings, Report and Recommendations are reflected in Record 173. The Special Master's Order is reflected in Record 327-329. The Findings, Report, Recommendations and Order were objected and excepted to by Baker & Taylor Drilling Co. as proposed Findings, Conclusions and Order [R. 157 *et seq.*].

The Special Master's Order adjudged and decreed that Tri-State Petroleum, Inc. had an equitable and conditional ¾ interest in the gas well and lease upon Section 2, subject to royalty and overriding royalties referred to in the Order, and ordered and directed that J. D. Amend transfer that interest to the Trustee of Tri-State, when the Trustee had satisfied ¾ of the indebtedness as set forth in the Findings, that when the debts and obligations are satisfied, Tri-State shall have the right, subject to approval of the court, to take such steps, at its own cost, to place the gas well on production; and further ordered that in the event Tri-State is unable to pay and satisfy the debts that it was directed to advertise the property for sale and sell the property free and clear of all liens and claims; and further ordered that Baker & Taylor Drilling Co. or anyone acting for or in its behalf, is estopped and enjoined and restrained from thereafter filing, prosecuting or taking any action in any court of any jurisdiction other than before the lower court against *J. D. Amend* or Tri-State Petroleum, Inc., or the Trustee in Bankruptcy of Tri-State Petroleum, Inc., based upon its claim growing out of the drilling of the gas well mentioned. It further ordered that the injunction and restraining order previously issued in the bankruptcy proceedings remain in force and effect [R. 327-329].

On November 3, 1964, Baker & Taylor Drilling Co. filed its Objections and Exceptions to the Report, Recommendations, Findings, Conclusions of Law and Order of the Special Master [R. 203 *et seq.*]. On November 4, 1964, Baker & Taylor Drilling Co. filed its motion for hearing upon its objections and exceptions [R. 230].

On February 19, 1964, the United States District Court for the Southern District of California entered its judgment denying the motion of Baker & Taylor

Drilling Co. regarding its Objections and Exceptions to the Findings, Report, Recommendations and Order of the Special Master, adopting the Findings and Conclusions of Law of the Special Master and adopting the Order of the Special Master as the order of the court [R. 233].

The amount involved is in excess of $500.00. The amount involved as to Baker & Taylor Drilling Co. is $25,871.63 [TR. 6, 122, 124, 125—March 24 hearing].

The United States District Court, Southern District of California, Central Division, had jurisdiction, under Rule 53(e), Federal Rules of Cvil Procedure; General Orders 52 and 47, General Orders in Bankruptcy (U.S.-C.A.—following Sec. 53, Title 11), adopted by the Supreme Court of the United States in 1961, to act upon and with respect to the Special Master's Report. Being a final judgment rendered in a controversy arising in bankruptcy, as contemplated by Section 24 of the Bankruptcy Act, 11 U.S.C. Sec. 47, this Court has appellate jurisdiction to review under said Section 24 of the Bankruptcy Act, 11 U.S.C. Sec. 47, which is made specifically applicable to Chapter X Bankruptcy proceedings by Section 121 of the Bankruptcy Act, 11 U.S.C. Sec. 521, under Title 28, Section 1291, U.S.C. and General Order 36, General Orders in Bankruptcy (U.S.C.A.—following Sec. 53, Title 11), adopted by the Supreme Court of the United States in 1961.

Alternatively, if this be deemed an appeal from an interlocutory order, which appellant urges it is not but that it is a final judgment rendered in a controversy arising in a proceeding in bankruptcy as contemplated by Section 24 of the Bankruptcy Act, this Court has jurisdiction to review on such interlocutory order under 28 U.S.C. 1292.

II.
Statement of the Case.

A. Questions Presented.

While, because of the nature of the proceeding involved, the Specifications of Error are more numerous, the questions herein basically involved are:

(1) Were the Special Master and the court below without jurisdiction to determine as between J. D. Amend and Baker & Taylor Drilling Co. the liability of J. D. Amend to Baker & Taylor Drilling Co. for debt under the contract between those parties?

(2) Were the Special Master and the court below without jurisdiction to determine rights and liabilities as between J. D. Amend and Baker & Taylor Drilling Co. with respect to property and property rights owned by J. D. Amend to which the debtor had no title or right, either legal or equitable?

(3) Were the Special Master and the court below without jurisdiction to enjoin and restrain or interfere with the exercise of rights by Baker & Taylor Drilling Co. against J. D. Amend by enjoining and restraining suits or actions in other courts by Baker & Taylor Drilling Co. against J. D. Amend for debt, or to maintain other personal actions against him?

(4) Were the Special Master and the court below without jurisdiction to determine any rights as between J. D. Amend and Baker & Taylor Drilling Co.?

(5) Were the Special Master and the court below without jurisdiction of the subject matter involved as to the gas well on Section 2 and the lease pertaining thereto?

(6) Were the Special Master and the court below without jurisdiction of Baker & Taylor Drilling Co. as

to the matter involved in the application of the Trustee for show cause order?

(7) Did the Special Master and the court below have jurisdiction to determine title to the gas well on Section 2 and the lease pertaining thereto?

(8) Was Baker & Taylor estopped to or from applying the $20,000.00 checks of Tri-State Petroleum, Inc. to the account of Tri-State Petroleum, Inc., as it did?

B. Manner in Which Questions Are Raised.

The manner in which the questions involved are raised is as follows:

(a) The plea of lack of jurisdiction by Baker & Taylor Drilling Co. [R. 114 *et seq.*].

(b) Baker & Taylor's Objections and Exceptions to the Special Master's proposed Report, Findings of Fact, Conclusions of Law and Order [R. 157 *et seq.*].

(c) The Special Master's Report, Findings of Fact and Conclusions of Law [R. 173 *et seq*].

(d) The Special Master's Order of October 26, 1964 [R. 327-329].

(e) Baker & Taylor Drilling Co.'s Objection and Exceptions to the Findings, Report, Recommendations and Order of the Special Master [R. 203].

(f) Judgment of the United States District Court of date February 19, 1965, denying and overruling the objections and exceptions of Baker & Taylor Drilling Co. to the Findings, Report, Recommendations and Order of the Special Master and adopting the Findings, Report, Recommendations and Order of the Special Master [R. 233].

A detailed record reference to the specific manner and place at which the questions are raised is included in the Appendix hereof as Appendix Exhibit 1 and is here referred to.

C. Statement of Facts.

This case arose in a proceeding for corporation reorganization of Tri-State Petroleum, Inc., a corporation, under Chapter X of the Bankruptcy Act [Petition, R. 2 *et seq.*]; application of Trustee for show came order [R. 107 *et seq.*]; show cause order [R. 116]; order of the United States District Court [R. 233].

Baker & Taylor Drilling Co. is a Delaware corporation with no permit to do business in the State of California, it does not do business in California and has never done business in California [R. Vol. 11, Reporter's TR—March 24, 25, 1964 proceeding].

J. D. Amend is a resident of Amarillo, Texas, and states his principal occupation is agriculture [TR. 8—March 24 hearing].

Tri-State Petroleum, Inc.'s petition for corporate reorganization under Chapter X, Bankruptcy Act, was filed June 17, 1963, in the United States District Court for the District of Nevada [R. 2] and approved by that Court on June 24, 1963 [R. 10-11]. R. W. Stafford was, by that Court at that time and in that Order, appointed Trustee [R. 11]. That Court found the indebtedness of the debtor corporation to be in excess of $250,000.00 [R. 11]. The June 24, 1963 order approving the petition contained the usual broad provisions restraining all persons from interfering by lawsuit and otherwise with the property of debtor and the Trustee [R. 17]. On August 15, 1963, the proceeding was transferred to the District Court of the United States for the Southern District of California, Central Division [R. 91].

Baker & Taylor Drilling Co. did not appear or file any pleading or instrument in the proceeding until after the show cause order. The involvement of Baker & Taylor in this cause is wholly involuntary as to it.

On or about February 19, 1964, Ronald Walker, Referee and Special Master, pursuant to an application filed by the Trustee, issued Order ordering that Baker & Taylor Drilling Co., J. D. Amend and other named persons appear before him on February 28, 1964, and show cause, if any, why they should not be required at such hearing to establish the amount of their claims and the validity of any claimed lien upon any property belonging to the debtor, including an oil and gas well located in Hansford County, Texas; and to show cause, if any, why any lien rights against such gas well should not be transferred to the funds received from the sale or operation of the well, and that pending the hearing it be held amenable to the restraining order of the court and restrained from commencing the prosecution of any litigation or from further prosecution of any litigation pending which sought a judgment or foreclosure of any claim against the property of the oil and gas well mentioned [R. 116].

Baker & Taylor Drilling Co. filed its plea asserting lack of jurisdiction of the property in Hansford County, lack of jurisdiction of the person of Baker & Taylor Drilling Co., lack of jurisdiction of the subject matter, lack of any title or property interest in the debtor in the Hansford County gas well property, and lack of jurisdiction to hear, determine and decree title into the debtor or the corporation or the Trustee in such property. Subject to its plea to the jurisdiction, Baker & Taylor answered as required by the show cause order [R. 141-151].

On February 28, 1964, J. D. Amend, *pro se,* filed pleading in which he alleged that: He was operator of the Wilbanks Well on Section 2, owned 25% of the working interest therein, did not recognize anyone as having an interest in the well until all bills have been paid, and H. F. Schlittler has described the manner in

which 75% is to be assigned, he has never dealt with Tri-State Petroleum, Inc., his 25% is in no way connected with the remaining 75%, he had expended $56,-024.69 in drilling and completing the well, in addition there were valid unpaid bills totaling $26,654.84, there is a claim of Baker & Taylor Drilling Co. of $27,536.78 that may or may not be valid and its validity and extent must be determined [R. 119]. On March 5, 1964, J. D. Amend, *pro se,* filed supplemental pleading alleging that all liens should be transferred to proceeds of sale, the only claim in question is that of Baker & Taylor Drilling Co., *"and whether it is declared valid completely or in part will be of no consequence to him."* [R. 139].

J. D. Amend's pleading in no manner raises any issue of rights between him and Baker & Taylor Drilling Co. and in no manner seeks determination of issues between them.

Pursuant to the show cause order, the Special Master proceeded to hear testimony and receive evidence on March 24 and 25, 1964, at which haering J. D. Amend, G. D. Bowie, Jr., Treasurer of Baker & Taylor Drilling Co., and H. F. Schlittler, last President of the debtor corporation, testified at the hearing [R. 1, 7, 60, 76, 99, Vol. II—TR. hearing on order to show cause]. On July 1 and 2, 1964, the Special Master heard additional testimony. At the July hearing G. D. Bowie, Jr. and J. D. Amend again testified; Roy L. Bulls, Secretary of Baker & Taylor Drilling Co., testified for the first time [R. Vol. III—Rep. Tr. of reset hearing on show cause order, July 1 and 2, 1964].

At the March hearing the Special Master announced that he would have to hear the matter before he could determine whether there is or is not jurisdiction [R. 8, Vol. II—TR. March 24-25 hearing]. The hearing

proceeded with Baker & Taylor reserving its jurisdictional plea with the Special Master's permission [R. Vol. II and III].

Two contracts with Baker & Taylor Drilling Co., each for the drilling of a well for oil or gas, are involved in the controversy as to Baker & Taylor Drilling Co. The contract fixing the relationship between Baker & Taylor and Tri-State Petroleum, Inc. is a distinctly different contract from the contract fixing the relationship between Baker & Taylor and J. D. Amend.

The contract fixing the relationship between Baker & Taylor Drilling Co. and Tri-State Petroleum, Inc. was a contract between Baker & Taylor Drilling Co. and *Tri-State Petroleum, Inc.* of date August 24, 1964, for the drilling by Baker & Taylor Drilling Co. of a well for oil or gas on Section 54, Block 4-T, T&NO Survey, Hansford County, Texas. It provided for payment to Baker & Taylor by Tri-State of a lump sum of $60,000.00 for the drilling of the well to the specified depth, together with any sums which might accrue for additional or extra work referred to as day rate compensation. The contract provided for $30,000.00 of the sum to be placed in escrow to be due at completion of the drilling of the well, "and the remaining sum to be due 30 days after completion of the drilling of the well." [R. 41—Deft. Ex. 30(a), Amend. Depo.; Baker & Taylor Ex. D]. The well drilled under this contract is sometimes referred to as the Nusbaum Well [TR. 40—March 24 hearing]. The $30,000.00 provided to be placed in escrow was delivered to Baker & Taylor in the form of check of Tri-State Petroleum, Inc. and receipted for September 21, 1962 [R. 46, Vol. II]. The check was deposited on that date and again on October 10, 1962 [Exs. 7(a), (b), (c), (d), (e), (f), Amend. Depo.]. Another check of Tri-State Petroleum, Inc. for

$5,000.00 was received by Baker & Taylor on October 26, 1962, and deposited [Exs. 11(b), (c), Amend. Depo.; Trustee's Ex. 3, Vol. II]. Another check of Tri-State Petroleum, Inc. for $5,000.00 was received by Baker & Taylor and deposited November 2, 1962 [Ex. 10, Amend. Depo.; Trustee's Ex. 4; R. 12, Vol. II]. The total net amount which became owing to Baker & Taylor Drilling Co. under the contract with Tri-State for the drilling of the Nusbaum Well was $70,036.63 [R. 105—March 24, 1964 hearing]. After application of the $40,000.00, represented by the above mentioned three checks, there remained yet owing under the Tri-State contract the sum of $30,036.63. There is no contention by anyone that this amount was not the correct amount owing at the time the incidents herein involved began to occur.

The contract fixing relationship between Baker & Taylor Drilling Co. and J. D. Amend was a contract between Baker & Taylor and *J. D. Amend* dated December 1, 1962, which provided for the drilling by Baker & Taylor Drilling Co. of a well for oil or gas on Section 2, Block 1, H&GN Survey, Hansford County, Texas. The contract provided for payment to Baker & Taylor Drilling Co. by J. D. Amend of a lump sum of $58,-000.00 for the drilling of the well to the specified depth, together with any sums which might accrue for additional or extra work referred to as day rate compensation. The contract provided that the "sum shall be payable to First Party by Second Party at Amarillo, Potter County, Texas, within thirty days after completion of the drilling of the well." [R.—Deft. Ex. 1, Amend Depo.]. The well drilled under this contract is sometimes referred to as the Wilbanks Well [TR. 48—March 24 hearing].

The wells provided for in the two contracts were drilled and there is no contention by anyone that either

well was not drilled as provided for in the contracts. The "Nusbaum" Well, drilled under the Tri-State Petroleum, Inc. contract, was completed October 3, 1962 [TR.—March 24 hearing]. The "Wilbanks" Well, drilled under the J. D. Amend contract, was commenced December 2, 1962, and completed December 22, 1962 [TR. 14—March 24 hearing].

Aside from and subject to the jurisdictional questions involved herein, the question involved herein is whether Baker & Taylor Drilling Co. was estopped to make application of a $20,000.00 *check of Tri-State Petroleum, Inc.* and $10,036.63 of another *check of Tri-State Petroleum, Inc.* to the *account of Tri-State Petroleum, Inc.* on account of the Nusbaum Well, as it did, rather than to the account of J. D. Amend on account of the Wilbanks Well.

Three $20,000.00 checks of Tri-State Petroleum, Inc., identified as Checks Nos. 127, 142 and 156, were received by Baker & Taylor Drilling Co. during December, 1962. Check No. 142 is Exhibit 13c to the Amend Deposition. Such deposition was offered and received as a whole [TR. 3—March 24 hearing]. That check was also offered and received as Trustee's Exhibit 5, page 18, Transcript March 24 hearing, and as Baker & Taylor Exhibit F offered and received [TR. 119—March 24 hearing]. Check No. 127 is Trustee's Exhibit 7 offered and received [TR. 19—March 24 hearing]. Check No. 156 is Trustee's Exhibit 8 offered and received [TR. 19—March 24 hearing]. Supplied herewith in Appendix is Appendix Exhibit 2, copy of Check No. 127; Appendix Exhibit 3, copy of Check No. 142; and Appendix Exhibit 4, copy of Check No. 156. All checks were received and currently applied more than six months before the Chapter X petition was filed.

Supplied herewith in Appendix is Appendix Exhibit 5, copy of Exhibit K, and Appendix Exhibit 6, copy of Exhibit L, which show the date each of the three checks was received by Baker & Taylor, when deposited and how applied.

Exhibit K was offered and received [TR. 7—July 1 hearing]. Exhibit L was offered and received [TR. 7—July 1 hearing]. The witness G. D. Bowie, Jr. testified that these exhibits summarized the transactions [TR. 9—July 1 hearing]. He testified at length as to the details which made up the exhibits [TR. 9—July 1 hearing]. No question has heretofore been raised but that Exhibits K and L reflect the facts, and we assume none will be raised here.

Check No. 127 [Trustee's Ex. 7; R. 111, 112; TR. —March 24 hearing] of Tri-State Petroleum, Inc., payable to Baker & Taylor Drilling Co. in the amount of $20,000.00 dated *December 17, 1962,* was received by Baker & Taylor Drilling Co. from Tri-State Petroleum, Inc. *December 13, 1962* [TR. 111—March 24 hearing], and deposited by Baker & Taylor on that date [Baker & Taylor Ex. E; TR. 113—March 24 hearing]. It was by the drawee bank on December 18, 1962 [TR. 112—March 24 hearing]. It had no designation of the application to be made of it, and Baker & Taylor received no direction from anyone as to how it should be applied [TR. 112-113—March 24 hearing]. Tri-State Petroleum, Inc. did not owe Baker & Taylor Drilling Co. any debt at the time of receipt of Check No. 127 except for the drilling of the Nusbaum Well [TR. 114—March 24 hearing]. Baker & Taylor Drilling Co. applied that check to Tri-State's indebtedness on account of Tri-State's contract with Baker & Taylor Drilling Co. dated August 24, 1962, in connection with the drilling of the Nusbaum Well on Section 54. The application of that check was currently made.

Check No. 142 [Baker & Taylor Ex. F; Trustee's Ex. 5] was received by Baker & Taylor Drilling Co. from *J. D. Amend* December 19, 1962, and receipted for by it by the receipt shown as Deposition Exhibit 12, Amend Deposition, which is in evidence. That check was dated December 15, 1962, was payable to Baker & Taylor Drilling Co. in the amount of $20,000.00, and had written on it "*on account of Section 2.*" That check was applied December 20, 1962, by Baker & Taylor Drilling Co. on the amount owing it by J. D. Amend on account of the contract with him in connection with Section 2. It was so applied pursuant to the designation on the check. It was deposited December 20, 1962 [R.—Ex. 13(a) Amend Depo.].

Check No. 156 [Trustee's Ex. 8] dated December 20, 1962, payable to Baker & Taylor Drilling Co. in the amount of $20,000.00, was received by Baker & Taylor Drilling Co. from Tri-State Petroleum, Inc. [TR. 115—March 24 hearing]. It had no designation as to how it should be applied [TR. 115—March 24 hearing], and Baker & Taylor Drilling Co. received no direction from anyone as to how it should be applied [TR. 116—March 24 hearing]. It was deposited December 17, 1962, by Baker & Taylor Drilling Co. Baker & Taylor Drilling Co. then currently applied $10,036.63 of such check to the payment of the balance of that sum owing it by Tri-State under its contract with Tri-State of August 24, 1962, on account of the drilling of the Nnsbaum Well on Section 54 [TR. 115, 119, 120—March 24 hearing]. Baker & Taylor Drilling Co. applied the remaining $9,963.37 to the payment of that amount yet owing it for the drilling of the Wilbanks Well on Section 2 [TR. 115, 119, 120—March 24 hearing], leaving as the balance owing it for the drilling of that well the sum of $25,871.63 [TR. 6, 122, 124, 125—March 24 hearing].

The Trustee contends, in this controversy, that the three $20,000.00 checks of Tri-State Petroleum, Inc. should have been applied to the indebtedness of J. D. Amend under his contract with Baker & Taylor and that the one check and part of the other, which was applied to the indebtedness of Tri-State Petroleum, Inc. under its contract, should not have been so applied. The Nusbaum Well was a dry hole [TR. 89—March 24 hearing], which no doubt accounts for the Trustee's desire to have the funds applied to the account of the Wilbanks Well.

Any interest of Tri-State Petroleum, Inc. in or to the well located on Section 2 or the leasehold estate under which it was drilled must arise, if at all, from a letter of J. D. Amend dated February 11, 1963, addressed to H. F. Schlittler. This letter appears as Exhibit 3 to the Amend Deposition and was introduced and received [TR. 3—March 24 hearing]. Copy of the letter is supplied herewith as Appendix Exhibit 7.

J. D. Amend testified that the above-mentioned letter was the only writing that he had made to anyone with respect to the assignment of any interest in the lease [TR. 54—March 24-25 hearing]. He testified that he had made some oral commitments to Mr. Schlittler [TR. 54—March 24-25 hearing].

Mr. Schlittler, who was President of Tri-State Petroleum, Inc., testified that he had an understanding with J. D. Amend that Tri-State was to pay $60,000.00 of the drilling costs or $60,000.00 on the development of the well, referring to the Wilbanks Well; [TR. 80—March 24-25 hearing] that before the commencement of the drilling of the well on Section 2 he had a conversation with Amend and that conversation was substantially confirmed by the above-mentioned letter [TR. 156, 166—March 24-25 hearing];

and that Tri-State's obligation to pay was to J. D. Amend and had nothing to do with the obligation of Amend and Baker & Taylor [TR. 167—March 24-25 hearing].

J. D. Amend, himself, did not hold title to the lease under which the well in question was drilled but only had an agreement with Phillips Petroleum Company to the effect that if a well were drilled within a certain time and in a certain manner, a leasehold interest would be assigned to him by Phillips, but only provided that Amend should furnish Phillips with evidence satisfactory to it that all bills for labor and material in connection with his operations had been fully paid. Phillips agreed that only then and thereupon it would, subject to other provisions, conditions and reservations, assign and transfer to Amend a leasehold interest in the lease. The lease has not been assigned to Amend by Phillips [Amend Depo. Ex. 2; see also Amend Depo. testimony pp. 9, 10, 11].

It is recognized by the Trustee and by J. D. Amend that there is yet unpaid, in connection with the drilling of the well, a lien indebtedness to Halliburton Company in the amount of $18,816.11, a lien indebtedness to Welex, a division of Halliburton Company, in the sum of $2538.36, and a lien indebtedness to Beacon Supply Company in the amount of $3709.88. In addition to these, is the claim of Baker & Taylor Drilling Co., which the Trustee sought to put at issue therein. It is also recognized that these items of expense are items of which Schlittler must pay ¾ in order to comply with the conditions of the letter [TR. 2-4—March 24 hearing]. The record reflects that there were more than $25,000.00 other expenses incurred upon which Schlittler was obligated to pay ¾ in order to comply with the conditions of the letter, but which he had not done [TR. 2—March 24 hearing].

Thus, it is completely obvious from the foregoing and from the Record herein that Tri-State Petroleum, Inc. does not have a title to any interest whatsoever in the well drilled on Section 2 and the leasehold estate under which it was drilled, but at most asserts and seeks to establish an equitable claim thereto which it sought to have the Bankruptcy Court ripen into a title or interest in the property.

While the letter from Amend to Schlittler of February 11, 1963, speaks in terms of 75% interest in the lease to be, under certain conditions, transferred to Schlittler, the Trustee only purports to claim 20½% interest in the working interest under the leasehold estate. By the report of the Trustee filed August 9, 1963, 20½% interest is set out as an interest claimed by Tri-State, Schedule 1-J to that report lists 41 other people, including J. D. Amend, who owned 66% interest [R. 25, 31, 32, 51]. We are not dealing with a property of Tri-State Petroleum, Inc. or even of Schlittler. The property was not and is not a property owned by Tri-State Petroleum, Inc., but if it has or had an equitable right to have adjudicated to it any title, which is denied, any such equitable right would extend only to 20½% interest. The Record reflects, without possibility of challenge by anyone, that at least 25% interest in the working interest under the lease is and was owned by J. D. Amend.

The Special Master and ultimately the District Court have gone far beyond the scope of the Trustee's application for show cause order and far beyond the scope of the show cause order. The Special Master sought (a) to find and adjudicate in the debtor or Trustee an interest in the property involved, though without finding or adjudicating what, or the quantum of that, interest; (b) to adjudicate questions of liability of J. D. Amend to Baker & Taylor Drilling Co. under the

contract between Baker & Taylor Drilling Co. and J. D. Amend; (c) to determine application of payments as between J. D. Amend and Baker & Taylor Drilling Co. as to a debt of J. D. Amend to Baker & Taylor Drilling Co.; (d) to adjudicate extinguishment of a debt of J. D. Amend to Baker & Taylor Drilling Co. with respect to which the debtor had no liability, primary, secondary or otherwise; (e) to adjudicate the invalidity of a lien claimed by Baker & Taylor Drilling Co. as to at least a 25% interest in the well on Section 2 and the leasehold estate under which it was drilled, which 25% interest admittedly was owned by J. D. Amend and to which the debtor had no right, claim, interest or relationship; (f) to adjudicate that Baker & Taylor Drilling Co. is estopped from asserting a claim against J. D. Amend, or from asserting a lien against the gas well or leasehold interest in Section 2, even as to the 25% interest therein admittedly owned by J. D. Amend and with respect to which the debtor has no right, title, claim or relationship; (g) to adjudicate title into the debtor or the Trustee of an interest in the property in question notwithstanding the fact that it is shown and established and the Special Master found that there yet exists $54,000.00 of costs of completing the well in question, of which sum the debtor was, by the only instrument or evidence under which it could acquire an interest, obligated to pay the sum of $41,038.88 before any claim or interest could be effected into it; (h) to enjoin Baker & Taylor Drilling Co. from prosecuting or taking any action in any court of any jurisdiction, other than before this Court, against J. D. Amend upon any claim growing out of the drilling of the gas well on Section 2; and (i) to enjoin Baker & Taylor Drilling Co. from prosecuting or taking any action to enforce a contract debt existing between Baker & Taylor Drilling Co. and J. D. Amend, executed

by them, to which contract the debtor was not a party and under which it had no liability to Baker & Taylor Drilling Co., primary, secondary or otherwise [Order of Special Master R. 327-329].

III.

Specifications of Errors.

1. The Referee and Special Master was without jurisdiction of Baker & Taylor Drilling Co. as necessary to enable him to enjoin, restrain or interfere with suits or actions in other courts by Baker & Taylor Drilling Co. against J. D. Amend as it did, and the District Court erred in holding that the Referee and Special Master had such jurisdiction [Baker & Taylor's Objections and Exceptions Nos. I, VIII, XX, XXI, XXII-(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a),(b),(c),(d) XXXI(a) and XXXII to the Special Master's Report —denied].

2. The District Court was without jurisdiction of Baker & Taylor Drilling Co. as necessary to enable it to enjoin, restrain or interfere with suits or actions in other courts against J. D. Amend as it did, and it erred in doing so.

3. The Referee and Special Master was without jurisdiction of Baker & Taylor Drilling Co. to determine as between J. D. Amend and Baker & Taylor Drilling Co. the liability of J. D. Amend to Baker & Taylor Drilling Co. under the contract between those parties, and the District Court erred in holding that the Referee and Special Master had such jurisdiction [Baker & Taylor's Objections and Exceptions Nos. I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report—denied].

4. The District Court was without jurisdiction of Baker & Taylor Drilling Co. to determine as between J. D. Amend and Baker & Taylor Drilling Co. the liability of J. D. Amend to Baker & Taylor Drilling Co. under the contract between those parties, and it erred in holding that it had such jurisdiction.

5. The Referee and Special Master was without jurisdiction of Baker & Taylor Drilling Co. to enjoin or restrain or interfere with suits or actions by it to enforce its rights against J. D. Amend not related to nor affecting the bankruptcy reorganization proceedings, and the District Court erred in holding that the Referee and Special Master had such jurisdiction [Baker & Taylor's Objections and Exceptions Nos. I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII-(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII-(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report—denied].

6. The District Court was without jurisdiction of Baker & Taylor Drilling Co. to enjoin or restrain or interfere with suits or actions by it to enforce its rights against J. D. Amend not related to nor affecting the bankruptcy reorganization proceedings, and the District Court erred in doing so.

7. The Referee and Special Master was without jurisdiction of Baker & Taylor Drilling Co. to determine as between J. D. Amend and Baker & Taylor Drilling Co. any rights and liabilities, and the District Court erred in holding that the Referee and Special Master had such jurisdiction [Baker & Taylor Drilling Co.'s Objections and Exceptions I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report—denied].

8. The District Court was without jurisdiction of Baker & Taylor Drilling Co. to determine as between J. D. Amend and Baker & Taylor Drilling Co. any rights and liabilities, and it erred in doing so.

9. The Referee and Special Master were without jurisdiction of Baker & Taylor Drilling Co. of the subject matter involved in the application of the Trustee for show cause, order, and the District Court erred in holding that the Referee and Special Master had such jurisdiction [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, II, XXI, XXIII, XXVII (1), (2), (4), (5)(a), (6), (7), (9) and (10), XVIII (a), (b), XXIX, XXX, XXXI to the Special Master's Report—denied].

10. The District Court was without jurisdiction of Baker & Taylor Drilling Co. of the subject matter involved in the application of the Trustee for show cause order, and it erred in not holding that it had no such jurisdiction.

11. The Referee and Special Master was without jurisdiction of Baker & Taylor Drilling Co. to enjoin or prohibit Baker & Taylor Drilling Co. from bringing or maintaining in other courts purely personal actions against J. D. Amend, and the District Court erred in holding that he had such jurisdiction [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII (1), (2), (3), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report—denied].

12. The District Court was without jurisdiction of Baker & Taylor Drilling Co. to enjoin or prohibit it from bringing or maintaining in other courts purely personal actions against J. D. Amend, and it erred in holding that it had such jurisdiction.

13. The Referee and Special Master was without jurisdiction of subject matter necessary to permit him to order that Baker & Taylor Drilling Co. is estopped and enjoined and restrained from filing, prosecuting or taking any action in any court of any jurisdiction other than the bankruptcy court in which the proceeding was pending below against J. D. Amend based upon its claim growing out of the drilling of the gas well mentioned and described in such proceedings [Baker & Taylor Drilling Co.'s Objections and Exceptions I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII-(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII-(a), (b), (c), (d), XXXI(a), and XXXII to the Special Master's Report. Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, II, XI, XXIII, XXVII(1), (2), (4), (5)(a), (6), (7), (9), (10), XVIII(a), (b), XXIX, XXX, XXXI to the Special Master's Report—denied].

14. The District Court was without jurisdiction of subject matter necessary to permit it to order that Baker & Taylor Drilling Co. is estopped and enjoined and restrained from filing, prosecuting or taking any action in any court of any jurisdiction other than the bankruptcy court in which the proceeding was pending below against J. D. Amend based upon its claim growing out of the drilling of the gas well mentioned and described in such proceedings.

15. The Referee and Special Master was without jurisdiction in a summary proceeding to determine title to the real estate involved and to decree title to same into the Trustee, and the District Court erred in holding that he had such jurisdiction [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, III, VIII, XX, XX(b), XXI, XXII(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10).

XXVIII(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report—denied].

16. There was no pleading or cause to bring Baker & Taylor Drilling Co. before the Referee and Special Master or the District Court or within its jurisdiction as to any rights existent between it and J. D. Amend such as to permit the Referee and Special Master to enjoin it from filing, prosecuting or taking action against J. D. Amend in any court, other than the court below, and the District Court erred in holding that the Referee and Special Master had such jurisdiction.

17. There was no pleading or cause to bring Baker & Taylor Drilling Co. before the Referee and Special Master or the District Court or within its jurisdiction as to any rights existent between it and J. D. Amend such as to permit the Referee and Special Master to enjoin it from filing, prosecuting or taking action against J. D. Amend in any court, other than the court below, and the District Court erred in holding that it had such jurisdiction.

18. The Referee and Special Master was without jurisdiction in the summary proceeding upon the application of the Trustee to require appearance of Baker & Taylor Drilling Co. in the proceeding below and to adjudicate title to real estate, and the District Court erred in not so holding [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, III, VIII, XX, XX(b), XXI, XXII(a), XXIII, XXIV, XXV, XXVII(a), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a), and XXXII to the Special Master's Report—denied].

19. The Referee and Special Master was without jurisdiction to bring Baker & Taylor Drilling Co. before the court below in summary proceedings and adjudicate rights of Baker & Taylor Drilling Co., and the Dis-

trict erred in not so holding [Baker & Taylor Drilling Co.'s Objections and Exceptions I, III, VIII, XX, XX-(b), XXI, XXIII(a), XXIII, XXIV, XXV, XXVII-(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII-(a), (b), (c), (d), XXXI(a), and XXXII to the Special Master's Report—denied].

20. The Referee and Special Master was without jurisdiction to bring Baker & Taylor Drilling Co. before the Court below in a summary proceeding and adjudicate the question of its lien as to property not even owned, and the District Court erred in not so holding [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, III, VIII, XX, XX(b), XXI, XXII(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)-(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a), and XXXII to the Special Master's Report —denied].

21. The Referee and Special Master was without jurisdiction to bring Baker & Taylor Drilling Co. before the court below in a summary proceeding and adjudicate the question of Tri-State Petroleum, Inc.'s debt to it, and the District Court erred in not so holding.

22. The Referee and Special Master purported to act beyond his jurisdiction with respect to subject matter of which he had no jurisdiction, and the District Court erred in not so holding.

23. The Referee and Special Master purported to act beyond his jurisdiction and with respect to persons as to whom he had no jurisdiction, and the District Court erred in not so holding.

24. The Referee and Special Master purported to act beyond his jurisdiction in ordering that Baker & Taylor Drilling Co. is estopped, and enjoining it, from taking any action in any court, other than the court below, against J. D. Amend or the Trustee based upon its

claim growing out of the drilling of the gas well involved, and the District Court erred in not so holding.

25. The District Court erred in overruling Baker & Taylor Drilling Co.'s objection and exception, which is its Objection and Exception No. II, to the Referee and Special Master's Finding of Fact No. II, asserting that such Finding of Fact is not supported by any evidence, is contrary to the evidence and is clearly wrong.

26. The District Court erred in adopting the Referee and Special Master's Finding of Fact No. II because same is not supported by any evidence, is contrary to the evidence and is clearly wrong.

27. The District Court erred in overruling Baker & Taylor Drilling Co.'s objection and exception, which is its Objection and Exception No. VII, to the Referee and Special Master's Finding of Fact No. VI, asserting that such Finding of Fact is not supported by any evidence, is contrary to the evidence and is clearly wrong.

28. The District Court erred in adopting the Referee and Special Master's Finding of Fact VI because such Finding of Fact is not supported by any evidence, is contrary to the evidence and is clearly wrong.

29. The District Court erred in overruling Baker & Taylor Drilling Co.'s objection and exception, which is its Objection and Exception No. VIII, to the Referee and Special Master's Finding of Fact No. VIII asserting that such Finding of Fact is not supported by any evidence, is contrary to the evidence and is clearly wrong.

30. The District Court erred in adopting the Referee and Special Master's Finding of Fact No. VIII because such Finding of Fact is not supported by any evidence, is contrary to the evidence and is clearly wrong.

31. The District Court erred in overruling Baker & Taylor Drilling Co.,'s Objection and Exception, which is its Objection and Exception No. IX, to the Referee and Special Master's Finding of Fact No. VIII, asserting that such Finding of Fact is not supported by the evidence, is contrary to the evidence and is clearly wrong.

32. The District Court erred in overruling Baker & Taylor Drilling Co.'s objection and exception, which is its Objection and Exception No. XXII, to the Referee and Special Master's Finding of Fact No. XIII, asserting that such Finding of Fact is not supported by the evidence, is contrary to the evidence and is clearly wrong.

33. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception, which is its Objection and Exception No. XX, to the Referee and Special Master's Finding of Fact XXV, asserting that such Finding of Fact is not supported by the evidence, is contrary to the evidence and is clearly wrong.

34. The District Court erred in adopting and approving the Referee and Special Master's Finding of Fact as follows:

> "Baker & Taylor Drilling Co. was informed and knew, on or about December 15, 1962, that these checks were mailed by Tri-State Petroleum, Inc. for the purposes in this paragraph set forth."

because same is not supported by evidence, but is contrary to the evidence and is clearly wrong.

35. The District Court erred in adopting and approving the Referee and Special Master's Finding of Fact as follows:

> "Notwithstanding this knowledge and request to so apply from J. D. Amend"

because same is not supported by any evidence, but is contrary to the evidence and is clearly wrong.

36. The District Court erred in adopting and approving the Referee and Special Master's Finding of Fact as follows:

> "Baker & Taylor Drilling Co. thereafter misinformed J. D. Amend as to the application of these funds and the manner set forth in Finding Paragraph VI and withheld the true facts from J. D. Amend and Tri-State Petroleum, Inc. to their disadvantage and detriment until after May 1, 1963"

because same is not supported by any evidence, but is contrary to the evidence and is clearly wrong.

37. The District Court erred in adopting and approving the Referee and Special Master's Finding of Fact as follows:

> "By reason of the above Baker & Taylor Drilling Co. is estopped from asserting a claim against J. D. Amend and/or Tri-State Petroleum, Inc., or from asserting a lien against the gas well or leasehold interest in Section 2 above described in any sum whatsoever"

because same is not supported by evidence, but is contrary to the evidence and is contrary to the law and facts; and for the further reason that the District Court or the Special Master had no jurisdiction to determine or adjudicate rights between Baker & Taylor Drilling Co. and J. D. Amend, nor with respect to rights or personal actions between them. As a matter of law under the established facts Baker & Taylor Drilling Co. was not estopped from asserting a claim against J. D. Amend or Tri-State Petroleum, Inc. or from asserting a lien against such property.

38. The District Court erred in adopting and approving the Referee and Special Master's Finding of Fact as follows:

> "Baker & Taylor Drilling Co. had been overpaid for the drilling of this gas well in the sum of $2800.00"

in that as a matter of law, on the basis of the evidence, Baker & Taylor has not been paid, but under the evidence there is yet owing and unpaid to Baker & Taylor Drilling Co. the sum of $25,871.63.

39. The District Court erred in sustaining Finding of Fact No. XXV because same is not supported by the evidence, is contrary to the evidence and because as a matter of law, under the evidence, the property in question was not being held by J. D. Amend for the benefit of himself and the debtor herein, but on the contrary was being claimed for himself.

40. The District Court erred in sustaining Finding of Fact No. XXV because J. D. Amend has no right or power to submit the property involved to the summary jurisdiction of the court as against Baker & Taylor Drilling Co. to the prejudice of Baker & Taylor Drilling Co., nor the lien right or any other right of Baker & Taylor Drilling Co. in the property to the summary jurisdiction of the bankruptcy court.

41. The District Court erred in sustaining Finding of Fact No. XXV because J. D. Amend has no right, power or authority to submit to the summary jurisdiction of the bankruptcy court his interest in the property involved to the prejudice of the lien of Baker & Taylor Drilling Co. as to the interest of J. D. Amend in and to the property involved.

42. The District Court erred in sustaining Finding of Fact No. XXV because any admission or concession of J. D. Amend with respect to the equitable or

conditional interest of Tri-State Petroleum, Inc. could not prejudice the rights of Baker & Taylor Drilling Co. with respect to the property involved, particularly with respect to the interest and ownership of J. D. Amend or as to the rights of Baker & Taylor Drilling Co. as against J. D. Amend.

43. The District Court erred in overruling Baker & Taylor Drilling Co.'s objection and exception, which is its Objection and Exception No. XXI, to the Referee and Special Master's Finding of Fact XXVI, asserting that such Finding of Fact is not supported by the evidence, is contrary to the evidence and is clearly wrong.

44. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception, which is its Objection and Exception No. XXII, to the Referee and Special Master's Finding of Fact XXVII, asserting that such Finding of Fact is not supported by the evidence. is contrary to the evidence and is clearly wrong.

45. The District Court erred in overruling and not sustaining Baker & Taylor Drilling Co.'s Objection and Exception No. XXIII to the Findings of Fact of the Referee and Special Master.

46. The District Court erred in adopting and approving the Referee and Special Master's Finding of Facts as against Baker & Taylor Drilling Co.'s Objection and Exception No. XXIII.

47. The District Court erred in overruling and not sustaining Baker & Taylor Drilling Co.'s Objection and Exception No. XXIV to the Findings of Fact of the Referee and Special Master.

48. The District Court erred in adopting and approving the Referee and Special Master's Finding of Facts as against Baker & Taylor Drilling Co.'s Objection and Exception No. XXIV.

49. The District Court erred in overruling and not sustaining Baker & Taylor Drilling Co.'s Objection and Exception No. XXV to the Findings of Fact of the Referee and Special Master.

50. The District Court erred in adopting and approving the Referee and Special Master's Finding of Facts as against Baker & Taylor Drilling Co.'s Objection and Exception No. XXV.

51. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(1) to the Conclusion of Law I of the Referee and Special Master, which Objection asserts lack of jurisdiction of the Referee and Special Master of Baker & Taylor Drilling Co. and of property involved.

52. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(2) to the Conclusion of Law I of the Referee and Special Master, which Objection asserts lack of jurisdiction to determine rights as between J. D. Amend and Baker & Taylor Drilling Co. and to determine and adjudicate personal actions as between them.

53. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(3) to the Conclusion of Law I of the Referee and Special Master, which Objection asserts lack of power or authority of J. D. Amend to offset or confer jurisdiction to determine rights as between J.D. Amend and Baker & Taylor Drilling Co.

54. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(4) to the Conclusion of Law II of the Referee and Special Master, which Objection asserts lack of jurisdiction to determine lien rights which Baker & Taylor Drilling Co. had with respect to the interest of J. D. Amend in and to the well located on Section

2 and the lease incident thereto, and to determine and adjudicate personal actions.

55. The Conclusions of Law of the Referee and Special Master are erroneous because, under the facts established, Baker & Taylor Drilling Co. was not estopped from applying funds received by it from Tri-State Petroleum, Inc. as it did, and the District Court erred in not so holding.

56. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(5)(a) to Conclusion of Law III of the Referee and Special Master, which Objection asserts that such Conclusion of Law exceeds the jurisdictional power, right and authority of the Special Master or the District Court and purports to adjudicate rights and claims as between J. D. Amend and Baker & Taylor Drilling Co., and the Referee and Special Master and the District Court have no jurisdiction to do so.

57. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception XXVII(5)(b) to Conclusion of Law III of the Referee and Special Master, because such Conclusion of Law is not supported by facts but is contrary to the facts and is an erroneous conclusion of law based upon an erroneous conclusion of fact.

58. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception XXVII(5)(c) to Conclusion of Law III of the Referee and Special Master, because such Conclusion contains an incorrect statement of fact and is predicated upon an incorrect statement or finding of fact.

59. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception XXVII(5)(d) to Conclusion of Law III of the Referee and Special Master, because as a matter of law, under the

facts established, Baker & Taylor Drilling Co. is not estopped from applying the funds received by it from Tri-State Petroleum, Inc. as it did upon the balance owing to it by Tri-State Petroleum, Inc.

60. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception XXVII(6) to Conclusion of Law X of the Referee and Special Master for the reason that the Referee and Special Master and the court below are without jurisdiction to restrain Baker & Taylor Drilling Co. from pursuing any and all rights or actions which it had against J. D. Amend and as against the interest of J. D. Amend in the Wilbanks Well on Section 2 and the lease incident thereto.

61. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception XXVII(7) to Conclusion of Law X of the Referee and Special Master because such Conclusion, when taken together with other Findings of Fact and other Conclusions of Law, would restrain, enjoin and prohibit Baker & Taylor Drilling Co. from proceeding against J. D. Amend to enforce an obligation of J. D. Amend to Baker & Taylor Drilling Co. to pay money which he had contracted to pay, and to enjoin, restrain and prohibit purely personal actions by Baker & Taylor Drilling Co. against J. D. Amend which the Special Master and the District Court were without jurisdiction to enjoin, restrain or prohibit.

62. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception XXVII(7) to Conclusion of Law X of the Referee and Special Master because such Conclusion, when taken together with other Findings of Fact and other Conclusions of Law, would enjoin, restrain and prohibit Baker & Taylor Drilling Co. from proceeding against

property owned by J. D. Amend, and never owned by the bankrupt and Trustee, to enforce a lien against the property owned by J. D. Amend, which the Court and Referee and Special Master, and each of them, were without jurisdiction to enjoin, restrain or prohibit.

63. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(10) to Conclusion of Law XIII of the Referee and Special Master because the District Court and the Referee and Special Master are without jurisdiction, right, power or authority as to rights and claims as between Baker & Taylor Drilling Co. and J. D. Amend and are without jurisdictional right, power or authority to adjudicate rights and particularly personal rights and personal causes of action existing between Baker & Taylor Drilling Co. and J. D. Amend and without jurisdiction, right, power or authority to adjudicate that Baker & Taylor Drilling is estopped and enjoined from filing, prosecuting or taking any action in any court of any jurisdiction other than the Court below against J. D. Amend based upon its claim growing out of the drilling of the gas well involved herein. The District Court and the Referee and Special Master were without jurisdiction, either of the subject matter or the parties, to enjoin the prosecution by Baker & Taylor Drilling Co. against J. D. Amend or to enjoin actions by Baker & Taylor Drilling Co. of the nature sought to be enjoined.

64. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(10) to Conclusion of Law XIII of the Referee and Special Master because such Conclusion is not supported by facts but is contrary to the facts and because such conclusion is an erroneous conclusion of law based upon an erroneous conclusion of fact.

65. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No.

XXVII(10) to Conclusion of Law XIII of the Referee and Special Master because such Conclusion of Law contains an incorrect statement of fact and is predicated upon an incorrect statement or finding of fact.

66. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(10) to Conclusion of Law XIII of the Referee and Special Master because as a matter of law under the facts established Baker & Taylor Drilling Co. was not estopped from applying the funds received by it from Tri-State Petroleum Inc. as it did upon the balance owing to it by Tri-State Petroleum, Inc.

67. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(11) to Conclusion of Law XIV of the Referee and Special Master because such finding is contrary to the evidence.

68. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXVII(11) to Conclusion of Law XIV of the Referee and Special Master because the uncontradicted evidence establishes that the check dated December 17, 1962, was delivered to Baker & Taylor Drilling Co. through the mail without restriction, condition or limitation as to the time of cashing or depositing same, same was honored and cashed by the bank upon which drawn when presented, and not paid by the drawee bank before its date.

69. The District Court erred in adopting the recommended Order of the Referee and Special Master signed October 26, 1964, because such Order, and each part thereof, was beyond the jurisdiction of the District Court.

70. The District Court erred in adopting the recommended Order of the Referee and Special Master signed

October 26, 1964, because the District Court and the Referee and Special Master had neither the jurisdiction, right, power or authority to enjoin or restrain Baker & Taylor Drilling Co. from pursuing personal actions against J. D. Amend, nor from pursuing lien actions against J. D. Amend's interest in the Wilbanks Well on Section 2, and his interest in the lease incident thereto agreed to be assigned to him by Phillips Petroleum Company, and was without jurisdictional right, power and authority to determine and adjudicate personal rights as between Baker & Taylor Drilling Co. and J. D. Amend.

71. The District Court erred in adopting the recommended Order of the Referee and Special Master signed October 26, 1964, because such Order was predicated upon erroneous Findings of Fact.

72. The District Court erred in adopting the recommended Order of the Referee and Special Master signed October 26, 1964, because the Order is not supported by facts but disregards established and uncontradicted facts under which and which make the Order clearly wrong.

73. The District Court erred in adopting the portion of the recommended Order of the Referee and Special Master signed October 26, 1964, being the second decretal paragraph of the Order beginning with "IT IS FURTHER ORDERED that in the event Tri-State Petroleum, Inc." and ending with "The Special Master's Findings of Fact and Conclusions of Law," because same was outside the jurisdiction of the District Court and was outside the jurisdiction of the Referee and Special Master, and the District Court and Referee and Special Master were without jurisdictional power or authority to so adjudicate, being without jurisdiction of

the subject matter and without jurisdiction of Baker & Taylor Drilling Co., and the District Court and Referee and Special Master did not have jurisdictional right, power or authority to order particularly the interest of J. D. Amend in the property sold free and clear of liens and claims of Baker & Taylor Drilling Co. and as a matter of law the District Court and Referee and Special Master did not have a legal right or authority to order the property sold free and clear of liens and claims against the property and particularly to order the interest of J. D. Amend in the property sold free and clear of the liens and claims of Baker & Taylor Drilling Co., or to transfer the liens and claims of Baker & Taylor Drilling Co. to funds received.

74. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXXI as to the seventh grammatical paragraph of the Order, being the sixth decretal paragraph of the Order beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending with "and described in these proceedings," for the reason that the District Court and the Referee and Special Master were without jurisdictional right, power or authority to enter such an order and to enjoin and restrain Baker & Taylor Drilling Co. as is so ordered in said paragraph, being without jurisdiction of the person of Baker & Taylor Drilling Co. for such purpose and being without jurisdiction of the subject matter of personal actions as to Baker & Taylor Drilling Co., and because such paragraph purports to adjudicate rights and claims as between J. D. Amend and Baker & Taylor Drilling Co., when the District Court and the Referee and Special Master did not have jurisdiction to do so.

75. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No.

XXXI as to the following part of the recommended Order of the Special Master, to-wit:

> As to the seventh grammatical paragraph of the order, being the sixth decretal paragraph of the Order, beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending with "and described in these proceedings."

because the Order contained in such paragraph is not supported by facts but is contrary to the facts and because such conclusion is an erroneous conclusion of law based upon erroneous conclusions of fact.

76. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXXI as to the following part of the recommended order of the Special Master, to-wit:

> As to the seventh grammatical paragraph of the Order, being the sixth decretal paragraph of the Order, beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending with "and described in these proceedings,"

because such Order is predicated upon incorrect findings of fact.

77. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXXI as to the following part of the recommended Order of the Special Master, to-wit:

> As to the seventh grammatical paragraph of the Order, being the sixth decretal paragraph of the Order, beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending with "and described in these proceedings,"

because, as a matter of law under the facts established, Baker & Taylor Drilling Co. was not estopped from applying the funds received by it from Tri-State

Petroleum, Inc. as it did upon the balance owing to it by Tri-State Petroleum, Inc.

78. The District Court erred in adopting the portion of the recommended Order of the Referee and Special Master, to-wit:

> As to the seventh grammatical paragraph of the Order, being the sixth decretal paragraph of the Order, beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending with "and described in these proceedings,"

for the reason that the District Court and the Referee and Special Master were without jurisdictional right, power or authority to enter such an order and to enjoin and restrain Baker & Taylor Drilling Co. as is so ordered in said paragraph, being without jurisdiction of the person of Baker & Taylor Drilling Co. for such purpose and being without jurisdiction of the subject matter of personal actions as to Baker & Taylor Drilling Co., and because such paragraph purports to adjudicate rights and claims as between J. D. Amend and Baker & Taylor Drilling Co., when the District Court the Referee and Special Master did not have jurisdiction to do so.

79. The District Court erred in adopting the following portion of the recommended Order of the Referee and Special Master, to-wit:

> As to the seventh grammatical paragraph of the Order, being the sixth decretal paragraph of the order, beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending with "and described in these proceedings,"

because the Order contained in such paragraph is not supported by facts but is contrary to the facts and because such conclusion is an erroneous conclusion of law based upon erroneous conclusions of fact.

80. The District Court erred in adopting the following portion of the recommended Order of the Referee and Special Master, to-wit:

> As to the seventh grammatical paragraph of the Order, being the sixth decretal paragraph of the Order, beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending with "and described in these proceedings,"

because such order is predicated upon incorrect findings of fact.

81. The District Court erred in adopting the following portion of the recommended Order of the Referee and Special Master, to-wit:

> As to the seventh grammatical pragraph of the Order, being the sixth decretal paragraph of the Order, beginning "IT IS FURTHER ORDERED that Baker & Taylor Drilling Co." and ending "and described in these proceedings,"

because, as a matter of law under the facts established, Baker & Taylor Drilling Co. was not estopped from applying the funds received by it from Tri-State Petroluem, Inc. as it did upon the balance owing to it by Tri-State Petroleum, Inc.

82. The District Court erred in overruling Baker & Taylor Drilling Co.'s Objection and Exception No. XXXII to the eighth grammatical paragraph of the recommended Order of the Referee or Special Master signed October 26, 1964, being the seventh decretal paragraph of such Order, because as to Baker & Taylor Drilling Co. there was no valid enforceable injunction or restraining order and because any injunction or restraining order as to Baker & Taylor Drilling Co. was beyond the jurisdiction of the District Court, and the District Court was without jurisdiction to enjoin or re-

strain Baker & Taylor Drilling Co. with respect to any property of J. D. Amend and with respect to claims and liens by Baker & Taylor Drilling Co. as against property of J. D. Amend or as against claims by Baker & Taylor Drilling Co. with respect to J. D. Amend's obligations to it.

83. The District Court erred in adopting the eighth grammatical paragraph of the recommended Order of the Referee and Special Master signed October 26, 1964, being the seventh decretal paragraph of such Order, because as to Baker & Taylor Drilling Co. there was no valid enforceable injunction or restraining order and because any injunction or restraining order as to Baker & Taylor Drilling Co. was beyond the jurisdiction of the District Court, and the District Court was without jurisdiction to enjoin or restrain Baker & Taylor Drilling Co. with respect to any property of J. D. Amend and with respect to claims and liens by Baker & Taylor Drilling Co. as against property of J. D. Amend or as against claims by Baker & Taylor Drilling Co. with respect to J. D. Amend's obligations to it.

84. The Referee and Special Master erred in holding that Baker & Taylor Drilling Co. was estopped to apply payments involved as it did because such holding is contrary to law, and the District Court erred in not so holding [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

85. The District Court erred in holding that Baker & Taylor Drilling Co. was estopped to apply payments involved as it did because such holding is contrary to law [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII-(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

86. The Referee and Special Master erred in holding that Baker & Taylor Drilling Co. was estopped to apply payments involved as it did because under the uncontradicted evidence it was not so estopped [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

87. The District Court erred in holding that Baker & Taylor Drilling Co. was estopped to apply payments involved as it did because under the uncontradicted evidence it was not so estopped [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

88. The Referee and Special Master erred in holding that Baker & Taylor Drilling Co. was estopped to apply payments involved as it did because such is contrary to the evidence and is clearly wrong [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

89. The District Court erred in holding that Baker & Taylor Drilling Co. was estopped to apply payments involved as it did because such is contrary to the evidence and is clearly wrong [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

90. Under the uncontradicted facts Baker & Taylor Drilling Co. had the right to apply the Tri-State Petroleum checks as it did and the evidence fails to establish any estoppel from applying such checks as it did, and it was clearly wrong for the Referee and Special

Master to hold that it was estopped from doing so [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII-(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

91. Under the uncontradicted facts Baker & Taylor Drilling Co. had the right to apply the Tri-State Petroleum checks as it did and the evidence fails to establish any estoppel from applying such checks as it did, and the District Court erred in failing to so hold [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

92. Under the uncontradicted facts Baker & Taylor Drilling Co. had the right to apply the Tri-State Petroleum checks as it did and the evidence fails to establish any estoppel from applying such checks as it did, and it was clearly wrong for the Referee and Special Master to hold that it was estopped from doing so, and the District Court erred in not so holding [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. VI, VII, VIII, XI, XII, XIII, XXII(5)(d) and (10), XXVIII(d), XXXI to the Special Master's Report—denied].

93. The Referee and Special Master had no right, power or authority to enjoin actions by Baker & Taylor Drilling Co. as he did against J. D. Amend in courts other than the Bankruptcy Court [Baker & Taylor Drilling Co.'s Objections and Exceptions I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c) and (d), XXXI(a) and XXXII to the Special Master's Report—denied].

94. The District Court had no right, power or authority to enjoin actions by Baker & Taylor Drilling

Co. as it did against J. D. Amend in courts other than the bankruptcy court.

95. The Referee and Special Master erred in granting injunctive relief beyond that necessary to conserve and protect the debtor or debtor's estate or to protect the jurisdiction of the bankruptcy court [Baker & Taylor Drilling Co.'s Objections and Exceptions I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report—denied].

96. The District Court erred in granting injunctive relief beyond that necessary to conserve and protect the debtor or debtor's estate or to protect the jurisdiction of the bankruptcy court [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report—denied].

97. The Referee and Special Master erred in granting injunctive relief which he had no right, power or authority to grant [Baker & Taylor Drilling Co.'s Objections and Exceptions Nos. I, VII, XX, XXI, XXII (a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI(a) and XXXII to the Special Master's Report —denied].

98. The District Court erred in granting injunctive relief which it had no right, power or authority to grant [Baker & Taylor Drilling Co.'s Objections and Exceptions I, VIII, XX, XXI, XXII(a), XXIII, XXIV, XXV, XXVII(1), (2), (3), (4), (5)(a), (6), (7), (10), XXVIII(a), (b), (c), (d), XXXI (a) and XXXII to the Special Master's Report—denied].

IV.

Summary of Argument.

With due regard to brevity and limitation of space for argument, reference is here made to Statement of the Case, pages 7 to 21 of this brief, as summary.

Specifications of Error 1 to 24, 37, 40, 41, 43, 45 to 50, 51 to 54, 56 to 61, 62, 63, 69, 70, 73 to 83 and 94 to 98 present the jurisdictional questions and argument thereunder, presented collectively in the interest of brevity.

The jurisdictional questions are those set out as (1) to (7) at pages 7-8 of this brief. They fall into three different categories and will be treated in this Argument under grouping and headings as follows:

A. Lack of jurisdiction of subject matter and of person of Baker & Taylor Drilling Co.;

B. Lack of jurisdiction to determine rights between Baker & Taylor Drilling Co. and J. D. Amend; and

C. Lack of jurisdiction to enjoin actions between Baker & Taylor Drilling Co. and J. D. Amend.

Specifications of Error Nos. 25 to 39, 41 to 50, 54, 55, 58 to 60, 64 to 70, 71, 72, 74, 75, 76, 77, 79, 80, 81, 84 to 93 present the questions with respect to application of payment and estoppel to apply payment, and argument will be presented here under grouping of:

D. No estoppel of Baker & Taylor Drilling Co. to apply payments as it did.

V.

Argument.

A. Lack of Jurisdiction of Subject Matter and of Person of Baker & Taylor Drilling Co.

The Trustee's application for a show cause order and seeking injunctive relief sought to adjudicate a claim of the Trustee to title to the above mentioned property.

The Trustee, by his agents, claimed the debtor to be entitled to only 20½% of the well and lease involved. He listed 66% interest owned by others, including 25% by J. D. Amend.

As a general proposition or rule the bankruptcy court in a Chapter X proceeding does not have jurisdiction in a summary proceeding of property not owned by or in at least the constructive possession of the debtor.

Collier on Bankruptcy, 14th Ed., Vol. 6, Sec. 305, p. 576, sets out the rule as to the jurisdiction of bankruptcy courts, saying:

> "Courts of bankruptcy are of statutory origin, and as previously indicated they possess only the jurisdiction and powers that are expressly or by necessary implication accorded them by statute."

In *In re Prima Co.*, 98 F. 2d 952 (7th Cir. 1938), involving a proceeding under Sections 77A and 77B, the court held and states:

> "Courts of Bankruptcy possess only such jurisdiction and powers as are expressly or impliedly conferred on them by Congress."

We are not unmindful of Section 2 of the Bankruptcy Act (11 U.S.C. 11) which is the jurisdictional section of the general bankruptcy statute, nor are we unmindful of Section 111 through Section 116 of the Bankruptcy Act (11 U.S.C. Sec. 511-516), which are

the jurisdictional provisions of Chapter X, Bankruptcy Act. We assume that this reference to such Statutes suffices without quoting therefrom. Sections 77A and 77B of the Bankruptcy Act were replaced by Chapter X (Colliers on Bankruptcy, 14th Ed., Vol. 6, Sec. 0.06, p. 63).

While the decision in *Taubel-Scott-Kitzmiller Co. v. Fox,* 264 U.S. 426, 68 L. Ed. 770, was before enactment of Chapter X, it is applicable with respect to summary and plenary jurisdiction of bankruptcy courts. The court there held:

> "Wherever the bankruptcy court had possession, it could, under the Act of 1898, as originally enacted, and can now, determine in a summary proceeding controversies involving substantial adverse claims of title under subdivision e of Sec. 67, under subdivision b of Section 60, and under subdivision e of Section 70. But in no case where it lacked possession could the bankruptcy court, under the law as originally enacted, nor can it now (without consent) adjudicate in a summary proceeding the validity of a substantial adverse claim. In the absence of possession, there was, under the Bankruptcy Act of 1898, as originally passed, no jurisdiction, without consent, to adjudicate the controversy even by a plenary suit."

In *Cline v. Kaplan,* 323 U.S. 97, 89 L. Ed. 99 (1954) it is held:

> "*A bankruptcy court has the power to adjudicate summarily rights and claims to property which is in the actual or constructive possession of the court.* Thompson v. Magnolia Petroleum Co., 309 US 478, 481, 84 L. Ed. 876, 879, 60 S.Ct. 628, 42 Am. Bankr. Rep. (NS) 216. If the property is not in the court's possession and a third person asserts

a bona fide claim *adverse to the receiver or trustee in bankruptcy,* he has the right to have the merits of his claim adjudicated 'in suits of the ordinary character, with the rights . . . and remedies incident thereto.' Galbraith v. Vallely, 256 U.S. 46, 50, 65 L.Ed. 823, 824, 41 S.Ct. 415; Kitzmiller Co. v. Fox, 264 US 426, Rep (NS) 912. But the mere assertion of an adverse claim does not oust a court of bankruptcy of its jurisdiction. Harrison v. Chamberlin, 271 US 191, 194, 70 L.Ed. 897, 899, 46 S. Ct. 467, 7 Am Bankr Rep (NS) 719. It has both the power and the duty to examine a claim adverse to the bankrupt estate to the extent of ascertaining whether the claim is ingenuous and substantial. Louisville Trust Co. v. Comingor, 184 US 18, 25, 26, 46 L.Ed. 413, 416, 22 S.Ct. 293, 7 Am Bankr Rep. 421. *Once it is established that the claim is not colorable nor frivolous, the claimant has the right to have the merits of his claim passed on in a plenary suit and not summarily.* Of such a claim the bankruptcy court cannot retain further jurisdiction unless the claimant consents to its adjudication in the bankruptcy court. MacDonald v. Plymouth County Trust Co., 286 US 263, 76 L.Ed. 1093, 52 S.Ct. 505, 20 Am Bankr Rep (NS) 1."

In *Harrison v. Chamberlin,* 271 U.S. 191, 70 L. Ed. 97, it is stated:

"It is well settled that a court of bankruptcy is without jurisdiction to adjudicate in a summary proceeding a controversy in reference to property *held* adversely to the bankrupt estate, without the consent of the adverse claimant; but resort must be had by the trustee to a plenary suit. (Citing cases) However, the court is not ousted of its jurisdiction by the mere assertion of an adverse

claim; *but, having the power in the first instance to determine whether it has jurisdiction to proceed, the court may enter upon a preliminary inquiry to determine whether the adverse claim is real and substantial or merely colorable. And if found to be merely colorable the court may then proceed to adjudicate the merits summarily; but if found to be real and substantial it must decline to determine the merits and dismiss the summary proceeding."*

In *In re Meiselman,* 105 F. 2d 995 (CCA 2d) it was held:

"It is now settled that if there is a real and substantial controversy of law or fact as to property held adversely to a bankrupt—'a contested matter of right, involving some fair doubt and reasonable room for controversy'—the bankruptcy court is 'without jurisdiction' to adjudicate the matter, but the trustee must have resort to a plenary suit."

In *In re Lake's Laundry,* 79 F. 2d 326 (CCA 2d) it is held:

"But, even though section 77B is a remedial statute to be construed liberally, we think Congress did not intend to ignore the distinction between property mortgaged by a debtor and property held by debtor as conditional vendee. The distinction has been recognized in legislation from early times, and was a part of the common law. The fact that Congress expressly included the words 'conditional sale agreement' in subdivision (o) (6) of section 75 of the act, 11 USCA, Sec. 203 (o) (6), and omitted any reference to conditional sales in subdivision (c) (10) of section 77B of the act, 11 USCA, Sec. 207(c)(10), is significant and points to the conclusion that it meant in this instance to

exclude property in the possession of the debtor whose rights therein were only those of a conditional vendee. We should not ignore the distinction."

In *Thompson v. Terminal Shares,* 104 F. 2d 3 (CCA 8th 1939) the court stated:

"To sustain the lower court's jurisdiction of this suit would do violence to the general policy of Congress that persons shall not be subjected to civil suits except in the districts of which they are inhabitants. Sec. 51 of the Judicial Code, 28 U.S.C. Sec. 112, 28 USCA Sec. 112; Sec. 23 of the Bankruptcy Act, 11 U.S.C. Sec. 46, 11 USCA Sec. 46; Robertson v. Labor Board, 268 U.S. 619, 627, 45 S.Ct. 621, 69 L.Ed. 1119. The language used by Congress in Section 77, in conferring jurisdiction upon the courts of bankruptcy, does not, in our opinion, indicate any intention to abandon that policy with respect to such suits as this. Compare United States v. Sweet, 245 U.S. 563, 572, 38 S.Ct. 193, 62 L.Ed. 473; First National Bank of Wellington v. Chapman, 173 U.S. 205, 214, 19 S.Ct. 407, 43 L.Ed. 669; Ex Parte Crow Dog, 109 U.S. 556, 572, 3 S.Ct. 396, 27 L.Ed. 1030; In Re Prima Co. Supra (98 F.2d 952, 958). We think that the jurisdiction conferred by Section 77 upon the courts of bankruptcy is not to be regarded as general, plenary, nationwide jurisdiction at law and in equity over all questions incident to the collection of the claims of the debtor against third persons, but is to be considered as the traditional jurisdiction of such courts over the property of a bankrupt, wherever located, freed, however, from those limitations which made ancillary proceedings in other districts necessary, and with the powers which Federal equity courts exercise in receiver-

ship proceedings, so far as those powers may be necessary or appropriate in order to preserve and safeguard the property in the actual or constructive possession of debtors and in order to carry on their business pending reorganization."

In *In re Standard Gas & Electric Co.,* 119 F. 2d 658 (CCA 3rd 1941) it was held:

"The jurisdiction which is exercised by courts of bankruptcy in summary form has uniformly been held to extend only to the person of the bankrupt and to property in his possession or in the possession of third persons who do not claim adversely to him or whose claims are colorable only. See Taubel-Scott-Kitzmiller Company, Inc. v. Fox, 264 U.S. 426, 44 S.Ct. 396, 68 L.Ed. 770. In that case, Mr. Justice Brandeis said (264 U.S. pages 430, 431, 44 S. Ct. page 398):

'Congress has, of course, power to confer upon the bankruptcy court jurisdiction to adjudicate the rights of trustees to property adversely claimed. In matters relating to bankruptcy its power is paramount. Hence, even if the property is not within the possession of the bankruptcy court, Congress can confer upon it, as upon any other lower Federal court, jurisdiction of the controversy, by conferring jurisdiction over the person in whose possession the property is. Congress has, also and subject to the constitutional guaranties, power to determine to what extent jurisdiction conferred, whether through possession of the res or otherwise, shall be exercised by summary proceedings and to what extent by plenary suit. But Congress did not, either by Section 2, Section 23 of the Bankruptcy Act of 1898 . . ., or any other provision of the Act, confer generally such broad jurisdiction over claims by a trustee against third persons.'

> "In Section 77B Congress likewise did not by any express language confer broad jurisdiction over claims by a debtor or its trustee against third persons. We think that such jurisdiction is not to be implied from the grant of jurisdiction over the debtor's property, but that the latter jurisdiction is essentially similar in nature to that possessed by courts of bankruptcy over the property of bankrupts."

Also in point and applicable are the cases of *In re Patten Paper Co.,* 86 F. 2d 761; *Reighardt v. Higgins Enterprises,* 90 F. 2d 569; and *Buss v. Long Island Storage Warehouse Co.,* 64 F. 2d 338, which are referred to.

That any submission by J. D. Amend to the jurisdiction of the Bankruptcy Court would not affect Baker & Taylor Drilling Co. and its rights to have its rights and claims adjudicated in a plenary suit rather than a summary proceeding is established by the decision in *Bay City Shovels, Inc. v. Schueler,* 245 F. 2d 73 (6th Cir. 1957).

It is submitted and urged that under the circumstances presented in this Record the Special Master and the Bankruptcy Court were without jurisdiction of the property in question. They certainly were without jurisdiction of the property to which the debtor had no conceivable claim. They certainly were without jurisdiction to adjudicate as between Baker & Taylor Drilling Co. and J. D. Amend as to the property owned by J. D. Amend to which the debtor had no conceivable claim. They certainly were without jurisdiction as to Baker & Taylor Drilling Co. as to the property to which the bankrupt had no conceivable claim and as to rights between Baker & Taylor Drilling Co. and J. D. Amend.

B. Lack of Jurisdiction to Determine Rights as Between Baker & Taylor Drilling Co. and J. D. Amend.

Any controversy as between J. D. Amend and Baker & Taylor Drilling Co. as to the rights between them is wholly unrelated to the purposes of the Bankruptcy Act or the purposes of this proceeding. Baker & Taylor Drilling Co. was not hailed into court by the Trustee's application for show cause order or by the show cause order or even by any pleading or process of J. D. Amend or in fact by any process for the purpose of adjudication of liability and obligations of J. D. Amend to it. Baker & Taylor Drilling Co. has not consented to the jurisdiction of this Court for the purpose of adjudicating the liabilities and obligations of J. D. Amend to it, but on the other hand has consistently protested the existence of any jurisdiction for any such purpose. The first manifestation of attempt to exercise any purported jurisdiction of liabilities and obligations of J. D. Amend to Baker & Taylor Drilling Co. came through the Special Master's report, recommendations and findings of fact and conclusions and proposed order after the July 1 hearing. Under the authorities hereinabove set out, no jurisdiction exists to such end and nowhere under the Bankruptcy Act nor under any other statute is any such jurisdiction granted. No predicate, by pleading or otherwise, process or otherwise, notice or otherwise, exists for the exercise of such jurisdiction.

A concise statement of the rule and authorities with respect to jurisdiction of the Bankruptcy Court of persons and over matters concerning which the bankrupt's estate has no interest is reflected in Collier on Bankruptcy, 14th Ed., Vol. 6, p. 587:

> "Ordinarily a court of bankruptcy will not take jurisdiction of a controversy between two parties over a matter concerning which the trustee of the

bankrupt estate has no interest. See Matter of Patten Paper Co., Ltd. (CCA 7th, 1936) 32 Am. B.R. (N.S.) 691, 86 F.2d 761; Morrison Rockhill Improvement Co. (CCA 10th 1937) 34 Am. B.R. (N.S.) 593, 91 F.2d 639; Matter of Lubliner and Trinz Theaters, Inc. (CCA 7th, 1938) 38 Am. B.R. (N.S.) 650, 100 F.2d 646, noted (1939) 7 U.Chi.L.Rev. 159 * * * * *However a court of bankruptcy—although it is a court of equity and has certain plenary jurisdiction—does not have plenary jurisdiction in equity to decide controversies between third persons having no relation to the reorganization proceedings. Sylvan Beach, Inc. v. Koch (CCA 8th, 1944) 55 Am. B.R. (N.S.) 409, 140 F.2d 852. See also Sec. 3.18, infra."

In 11 Remington on Bankruptcy (1961 Ed.) Sec. 4370, it is stated:

"Chapter X, like its predecessor, Section 77B, confines itself to adjustments between the debtor and its creditors. Legal transactions with third parties are left to those courts which have cognizance of them generally. And while a claim by debtor against a third person is property of the debtor, and as such, the reorganization court may direct its prosecution by the trustee if appropriate to effect the debtor's reorganization, it is a species of property which may only be realized upon for the benefit of the debtor and its creditors by the successful prosecution of a plenary suit against the third persons involved, and not through summary proceedings. Claims which do not involve the debtor or its property are not within the court's jurisdiction. The court will not take jurisdiction of collateral disputes between third parties unless their settlement is a necessary step in reorganization."

The rule is stated in *Sylvan Beach v. Koch,* 140 F. 2d 852 (8th Cir. 1944) in a Chapter X proceeding as follows:

> "A court of bankruptcy is a court of equity within a limited field. It has, however, no plenary jurisdiction in equity. Smith v. Chase National Bank, 8 Cir., 84 F.2d 608, 614, 615; United States v. Killoren, 8 Cir. 119 F.2d 364, 366. It has jurisdiction to adjudicate controversies related to property of which it has actual or constructive possession. Thompson v. Magnolia Petroleum Co., 309 U.S. 478, 481, 60 S.Ct. 628, 84 L.Ed. 876. *It has no jurisdiction to hear and determine controversies between adverse third parties which are not strictly and properly part of the proceedings in bankruptcy.* Brumby v. Jones, 5 Cir., 141 F. 318, 320; Chauncey v. Dyke Bros., 8 Cir., 119 F. 1, 3; Brockett v. Winkle Terra Cotta Co., 8 Cir. 81 F. 2d 949, 952; Smith v. Chase National Bank, 8 Cir. 84 F.2d 608, 615; Morrison v. Rockhill Imp. Co., 10 Cir., 91 F.2d 639, 642."

In *Kaplan v. Guttman,* 217 F. 2d 481 (9 Cir. 1954) this Honorable Court quoted with approval and encompassed the rule above quoted from *Sylvan Beach v. Koch.* This Court further held in *Kaplan v. Guttman:*

> "It is an axiom that consent cannot provide jurisdiction. Only where Congress has conferred power on the court to hear and determine a particular kind of controversy, can adverse parties consent to exercise of judicial authority over persons or rights. But it has been seen here, no mandate has been given by law to settle this dispute between third parties as to property in which the bankrupt has neither right, title nor possession. Consent is of no avail."

Smith v. Chase National Bank, 84 F. 2d 608 (8 Cir., 1936) and the other cases cited in *Sylvan Beach v. Koch, supra,* hold as in *Sylvan Beach v. Koch, supra.*

The Special Master's Order of October 26, 1964, which was approved and adopted by the Judge and District Court, orders that Baker & Taylor Drilling Co. is estopped, and enjoins and restrains it, from filing, prosecuting or taking any action in any court of any other jurisdiction than the court below (*i.e.* the United States District Court for the Southern District of California, sitting as a bankruptcy in the bankruptcy proceeding) against *J. D. Amend* or Tri-State Petroleum, Inc., based upon its claim growing out of the drilling of the gas well. The debt to Baker & Taylor Drilling Co. arose by a contract between J. D. Amend and Baker & Taylor Drilling Co. The obligation to Baker & Taylor Drilling Co. was owed it by J. D. Amend and not by Tri-State Petroleum, Inc. Baker & Taylor Drilling was not within the territorial jurisdiction of the lower court. It had not submitted to the jurisdiction of that court. It had not been hailed into court as to rights as between it and J. D. Amend. Determination of rights between Baker & Taylor Drilling Co. was not incident or necessary to any matter involving the debtor. The Special Master and ultimately the District Court have attempted to adjudicate and determine a cause of action between two third parties who were not before it for any such purpose, and which cause of action was not involved and not before them. Such was not within the jurisdictional power or authority of the Special Master or the District Court.

C. Lack of Jurisdiction to Enjoin Actions by Baker & Taylor Drilling Co. Against J. D. Amend.

It is urged that any suit by Baker & Taylor Drilling Co. against J. D. Amend for debt would not involve or concern Tri-State Petroleum, Inc. or any of its property. A money judgment by Baker & Taylor Drilling Co. against J. D. Amend could not affect the debtor or the debtor's estate. It is in no wise necessary that this Court or the Referee and Special Master enjoin personal actions by Baker & Taylor Drilling Co. against J. D. Amend for a money debt or enjoin foreclosure by Baker & Taylor Drilling Co. of lien against the interest of J. D. Amend in the property in question in order to protect the debtor, the debtor's estate or the Trustee, nor is it within the jurisdiction of the court to do so. Under no conceivable stretch of the imagination is it necessary that Baker & Taylor Drilling Co. be enjoined for personal actions of J. D. Amend for money judgment in order to fully and adequately protect the debtor and any claim or interest which it has. At no place in the Bankruptcy Act, either Chapter X or otherwise, is there any statutory provision granting any jurisdiction in the bankruptcy court, or granting any right to an injunction such as the Referee or Special Master undertakes.

Section 116(4) provides that the court may:

> "Enjoin or stay until final decree the commencement or continuation of a suit against a debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor."

That section certainly does not authorize an injunction against Baker & Taylor Drilling Co. from pursuing a suit against J. D. Amend for a money judgment.

28 U.S.C. Sec. 2283, entitled "Stay of State Court Proceedings" reads as follows:

"A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect of effectuate its judgments."

The Acts of Congress which clothe the Bankruptcy Court with powers to issue injunctions are above mentioned. It is important to note that Section 116(4) of the Bankruptcy Act provides for the issuance of injunctions to stay suits *against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.* A personal action for debt by Baker & Taylor Drilling Co. against Amend is clearly without the injunctive scope of the Bankruptcy Court under that Section.

In 11 Remington on Bankruptcy (1961 Ed.) Section 4389, it is stated:

"Acting under the rule that the reorganization court should control all litigation against the debtor except in very special cases, the Chapter X courts have entered stays in a number of fact situations. For example, it has been held that suits between creditors as to the validity and priority of their respective liens on a debtor's property cannot be maintained after a general stay. . . .

"Suits against officers of the debtor corporation will not be stayed, ordinarily. Such a suit should be stayed, however, notwithstanding the corporation is not a party, if its property will be affected by the judgment or decree. A court of bankruptcy is without jurisdiction or power to grant an injunction restraining an execution sale of property owned individually by an officer of the debtor. Even though a state court suit against the president and secretary of the debtor in reorganization on their

> guaranty of the debtor's obligations may have an indirect repercussion in the reorganization proceeding in the Bankruptcy Court, the court does not have the power to stay such suit. . . ."

In *In re Magnus Harmonica Corp.,* 233 F. 2d 803 (3rd Cir. 1956), the District Court had issued, in a Chapter X reorganization proceeding, an injunction to stay a suit brought against the president and secretary of the bankrupt corporation. The two officers of the corporation had guaranteed obligations of the corporation, and the olbigee of the guaranty filed suit in a state court in New Jersey against the officers on the contract of guaranty. After that state court suit was stayed by an order of the district court, the present motion was then filed seeking to stay the bankruptcy court's injunctive order pending an appeal thereof from such order. The court quotes 28 U.S.C. Sec. 2283, above quoted, and says that it is of the clear opinion that the motion to stay the injunction must be granted. This court says that if there is any reason at all for the injunction against the state court suit, it is under the provision granting power to grant such an injunction where it is in aid of jurisdiction of the Federal court. The opinion then quotes from a United States Supreme Court decision of *Calloway v. Benton,* 93 L. Ed. 553, where it is stated that Congress by no means intended to give the Bankruptcy Court exclusive jurisdiction over all matters and controversies that in some way affect the debtor's estate. The court after quoting 28 U.S.C. Sec. 2283, above quoted, stated:

> "If there is any basis for the injunction against the state suit here, it is under the permission to grant it where it is in aid of the jurisdiction of the Federal court. The Federal court has, of course, jurisdiction in the bankruptcy matter. But, as stated by Chief Justice Vinson for the Supreme Court

in Callaway v. Benton, 1949, 336 U.S. 132, 142, 69 S.Ct. 435, 441, 93 L.Ed. 553, 'there can be no question, however, that Congress did not give the bankruptcy court exclusive jurisdiction over all controversies that in some way affect the debtor's estate . . .'

"*It may be granted that this suit against the Magnus defendants may have an indirect repercussion in matters involved in the bankruptcy proceedings.* It is suggested, for instance, that Finn Magnus has reversionary rights to certain patents now licensed to the corporation and if a creditor got hold of those rights it would greatly embarrass the reorganization." (Emphasis added.)

In *In re Magnus Harmonica Corporation,* 237 F. 2d 867 (3rd Cir. 1956) is the appeal from the bankruptcy court's order enjoining the state court suit discussed in the above case. The court says that the only question for it to decide is whether the injunction was one which was necessary to protect the jurisdiction of the Bankruptcy Court. If not, the court says, it is forbidden by the provisions of Section 28 U.S.C. Sec. 2283. The court notes that the defendants here are officers of the corporation being sued in their individual capacities on a contract of guaranty which is broad enough to permit suit against them without first resorting to the primary obligor. The court's opinion reads in part as follows:

"Counsel for the Magnuses make much of the fact that a surety has a right both under the law of New Jersey and generally to be exonerated by the principal debtor before he pays the creditor and to subrogation to the creditor's rights after he pays. Exoneration, it is said, is an equitable right which the surety has against the principal debtor to compel the latter to shoulder the obligation instead of foisting it on the surety."

The court then points out that it need not decide whether there is any procedure in the bankruptcy court to permit the corporate officers to assert their rights to be exonerated. Important language is the following:

> "We need not decide whether there is any procedure in the bankruptcy court by which the Magnuses can force the estate to exonerate them pro rata. If not, that is one of the unfortunate consequences of guaranteeing the debt of one who goes bankrupt. *Assuming arguendo that the equity of exoneration cannot be enforced and that to enjoin the state suit would protect the sureties, it does not follow that an injunction is necessary to protect the jurisdiction of the bankruptcy court.*"

The court then discussed specific provisions of the Bankruptcy Statute which deal with the right of subrogation for a surety who pays the principal's debt. After quoting Section 57, Subdivision i (11 U.S.C.A. sec. 93) to the Bankruptcy Act, which provides that a surety can file a claim with the Bankruptcy Court in the name of the creditor, the court says:

> "This quoted section is the statutory limitation upon a surety's proof of claim in the Bankruptcy Court. But that court, nevertheless, has full control over all the assets of the bankrupt. *That control is unaffected by whatever goes on outside the Bankruptcy Court in litigation between one of the bankrupt's creditors and a party who had independent liability on one of the bankrupt's contracts.*"

In *In re Diversey Building Corp.*, 86 F. 2d 456 (7th Cir. 1936) (cert. den. in Diversey Building Corp. v. Weber, 81 L. Ed. 870, 300 U.S. 662, 57 S. Ct. 492), the debtor had issued bonds secured by a deed of trust on its property and one Becklenburg had unconditionally guaranteed payment of the bonds. Webber, the

holder of one of the bonds, had sued Becklenburg in state court. Thereafter the debtor filed for corporate reorganization under Section 77B of the Bankruptcy Act. The debtor filed, in the district court, a petition for restraining order. Webber ultimately denied the court's jurisdiction to restrain him from proceeding against Becklenburg. The Master granted injunction perpetually enjoining Webber and others from prosecuting any suits against either the debtor or Becklenburg on account of any of the bonds. On appeal it was held that the court had exceeded its jurisdiction in enjoining Webber from suit against Becklenburg, holding that the court's power to enjoin did not extend beyond the power of the court to protect its jurisdiction and its orders which do not exceed the limitation of its jurisdiction. Quotation of the court's discussion of the matter is supplied herewith for ready reference as Appendix Exhibit 9.

The Bankruptcy Court has no plenary jurisdiction in equity but is confined in the application of the rules and principles of equity to the jurisdiction conferred upon it by the Bankruptcy Act, reasonably interpreted. *United States v. Killoren,* 119 F. 2d 364 at p. 366 (8th Cir. 1941); *Smith v. Chase National Bank, supra;* to the same effect is *Sylvan Beach v. Koch, supra.*

In *In re Commonwealth Bond Corporation,* 77 S.W. 2d 308 (CCA 2d 1935) at pages 309 and 310 the court held in a 77B proceeding:

> "Stays must be ancillary to the main purpose of the proceeding and are not lawful when they cannot contribute to the execution of the plan."

In *In re Nine North Church Street, Inc.,* 82 F. 2d 186 (CCA 2d 1936), a Section 77B proceeding, the court stated:

> "The Bankruptcy Act points out the limitations on the court's power to enjoin. Suits against the debtor

> or to enforce any lien on his estate may be restrained. Section 77B (c) (10), 11 U.S.C.A. Sec. 207 (c) (10). An indefinite power to enjoin in aid of the court's jurisdiction is granted by Section 262 of the Judicial Code (28 U.S.C.A. Sec. 377). Section 2 (15) of the Bankruptcy Act (11 U.S.C.A. Sec. 11 (15)) gives bankruptcy courts power to make orders necessary for the enforcement of the provisions of the act. *But that the writ of injunction can be exercised beyond the dictates of necessity is denied by Section 265 of the Judicial Code (28 U.S.C.A. Sec. 379).*"

Argument and Authorities under Subdivision B Lack of Jurisdiction to Determine Rights as Between Baker & Taylor Drilling Co. and J. D. Amend, foregoing herein, are applicable to and are here referred to. The Order enjoining and restraining Baker & Taylor Drilling Co. from taking action in any other court against J. D. Amend, if effective, is by injunctive action to restrain Baker & Taylor Drilling Co. from pursuing a course of action against J. D. Amend, which cause of action was never within the jurisdiction of the Special Master or the lower court, which does not in any manner involve the debtor or the debtor's property and as between the parties not before the court for any such purpose. No such jurisdiction, power or authority has been conferred on the Special Master or the Court.

D. No Estoppel of Baker & Taylor Drilling Co. to Apply Payments as It Did.

Reference is made to "C" Statement of Facts under Statement of the Case. pages 9 to 22 of this brief, for full discussion of the three checks involved and dates of receipt, deposit and application thereof.

Baker & Taylor Exhibits K and L offered and received [TR. 8—July 1 hearing] reflect the full and

complete accounts with respect to the two wells, showing date of receipt of, deposit of and application of each check. These exhibits tell the story in detail of receipts, deposits and application of the three checks of Ti-State Petroleum, Inc. of $20,000.00 each, which were received by Baker & Taylor Drilling Co. A copy of each Exhibit K and L is attached to this brief as Appendix Exhibits 5 and 6, respectively. Also supplied herewith as Appendix Exhibit 8 is Exhibit M which refers to original records which support Exhibits K and L. Exhibit M was offered and received in evidence at page 8 of Transcript of July 1 hearing.

J. D. Amend testified time and again that he did not direct Baker & Taylor Drilling Co. as to any application or as to how any check was to be applied [Amend Depo. 31, 32—TR. 51, 52, 53—March 24-25 hearing; TR. 108—July 1-2 hearing].

J. D. Amend testified that he had no instruction from Tri-State as to application of payments [Amend Depo. 29].

H. F. Schlittler, President of Tri-State Petroleum, Inc., testified with respect to the issuances of the three $20,000.00 checks and was the only person connected with Tri-State who testified, testified that he did not direct anything to Baker & Taylor Drilling Co. with respect to application of payments [R. 167, 168—TR. March 24 hearing].

While three $20,000.00 checks of Tri-State Petroleum, Inc. were received by Baker & Taylor Drilling Co., the court does not need concern itself with Check No. 142 for $20,000.00 because that check, on its face, directed application to the account of the Wilbanks Well on Section 2 and was so applied, as the Trustee and J. D. Amend contend it should have been, and as the Special Master and Court found it should have been

applied. The court is concerned with the application of Checks Nos. 127 and 156. There is no relationship between the dates shown on the three checks and the dates on which they actually were received by Baker & Taylor Drilling Co. They were not received in the order which the date on the check bore [see Appendix Exs. K and L].

The findings upon which the Special Master predicated his Finding and Conclusion of Estoppel and his Order thereon are Findings of Fact Nos. V, VI, VIII and XXVII, in which the Special Master found:

in Finding of Fact No. V the execution of the contract for the drilling of the Nusbaum Well on Section 54, that the total charge therefor was $70,036.63, that Amend delivered three checks totaling $40,000.00 payable to Amend and endorsed by him and left a balance of $30,036.63 due Baker & Taylor Drilling Co. from Tri-State Petroleum, Inc. for the drilling of that well, that Amend was not aware and not informed that all of those costs had not been paid;

in Finding of Fact No. VI that Tri-State Petroleum, Inc., pursuant to oral agreement with Amend to advance the drilling costs for the Wilbanks Well on Section 2, mailed Amend the check dated December 15, 1962, in the sum of $20,000.00, payable to Baker & Taylor Drilling Co. and marked on the stub *"on account of Section 2"* that Amend immediately took the check to Roy Bulls, Secretary to Baker & Taylor Drilling Co., and delivered it to him and at the time of such delivery Amend stated to Bulls that Tri-State had agreed to pay the $60,000.00 drilling costs for the Wilbanks Well, that he did not want to carry a further interest in the well and that he could not afford to, and that if Tri-State didn't come up with the money, he wanted to be informed about it, that he had some other people he thought would buy the interest, and

that Bulls then and there told Amend that he would notify him whether or not his company received further payment, and that within a few days Bulls called Amend and told Amend that his company had received a third check from Tri-State in the sum of $20,000.00 or a total of $60,000.00, that while the check dated December 15, 1962 made payable to Baker & Taylor Drilling Co. was delivered through Amend, the other two checks each were mailed directly to Baker & Taylor Drilling Co., that there was no statement on the checks indicating the purpose for which they were delivered, that the total drilling costs of the Wilbanks Well was the sum of $57,200.00, that had the three $20,000.00 checks been applied toward the drilling of the Wilbanks Well, as intended by Tri-State and J. D. Amend, there would have been an overpayment of $2800.00 for the drilling costs, that when Baker & Taylor received the check dated December 17 it was applied upon the Nusbaum Well and when the check dated December 20, 1962, was received, $10,036.63 of it was applied on the Nusbaum Well, that the application of the funds to payment of the Nusbaum Well was without knowledge of Tri-State or J. D. Amend;

in Finding of Fact No. VIII, that the three $20,000.00 checks were mailed to Amend and Baker & Taylor in the manner described above for the purpose of paying drilling costs on the Wilbanks Well and to enable Tri-State to acquire ¾ interest in that well from Amend, when the terms of that letter had been complied with, that Baker & Taylor was informed and knew on or about December 15, 1962, that the checks were mailed by Tri-State for the purposes above, and notwithstanding this knowledge and request to so apply from J. D. Amend, applied a portion of said payments to the Tri-State account for the drilling of the Nusbaum Well, that thereafter Baker & Taylor misinformed

J. D. Amend as to the application of the funds and withheld the true facts from Amend and Tri-State to their disadvantage and detriment, and "that by reason of the above, Baker & Taylor Drilling Company are estopped from asserting a claim against J. D. Amend and/or Tri-State Petroleum, Inc., or from asserting a lien against the gas well or leasehold interest on Section 2 in any sum whatsoever." Baker & Taylor Drilling Co. "have" been overpaid for the drilling this gas well in the sum of $2800.00; and

in Finding of Fact XXVII that the claim of Baker & Taylor under the drilling contract with J. D. Amend has been paid in full by money furnished by Tri-State Petroleum, Inc. pursuant to its agreement with J. D. Amend.

The Special Master's Findings of Fact Nos. I through VIII are reflected in the Record, pages 176 to 182; Finding of Fact No. XXVII is reflected in the Record, pages 189, 190. Reference is here made to the Record at such pages for the full text of such Findings.

By Conclusion of Law No. III the Special Master concluded that the claim and defense of estoppel asserted by the Trustee and J. D. Amend against the claim of Baker & Taylor Drilling Co. by virtue of the information received by it from J. D. Amend on or about December 15, 1962, to the effect that Tri-State Petroleum, Inc. was to pay the drilling costs of the gas well, and by request of J. D. Amend to be advised as to whether or not future payments were made upon the cost of the well, and the statement by Roy Bulls to J. D Amend that the drilling costs had been so paid, was found to have been made in the Finding of Facts, are true and are sufficient to sustain the plea of estoppel and does estop Baker & Taylor Drilling Co. from applying the funds received from Tri-State Petroleum,

Inc. upon the balance due it from Tri-State Petroleum, Inc. for the drilling of the well on Section 54. Such Conclusion of Law No. III is reflected at pages 190 and 191 of the Record.

Baker & Taylor Drilling Co.'s Objections and Exceptions to Findings of Fact V, VI, VII and VIII are its Objections and Exceptions Nos. VI, VII, VIII and IX reflected at pages 205 to 208 of the Record, are to the effect that each such Finding is not supported by any evidence, is contrary to the evidence and is clearly wrong. Its Objection and Exception to Finding of Fact XXVII is its Objection and Exception XXII reflected at pages 213 and 214 of the Record. Its Objection and Exception to Conclusion of Law III is its Objection and Exception No. XXVII(5) reflected at page 219 of the Record. Reference is made to the Record and the aforesaid pages for the Objections and Exceptions.

By the Special Master's Order it is ordered that Baker & Taylor Drilling Co., its assignees or anyone acting for or in its behalf, is estopped and enjoined and restrained from filing, prosecuting or taking any action in any court, other than the court below, based on any of its claim growing out of the drilling of the gas well. Baker & Taylor Drilling Co.'s Objection and Exception to that portion of the Order, insofar as the estoppel question is concerned, is its Objection and Exception No. XXXI reflected at pages 224 and 225 of the Record. Reference is here made to the Record for the full text of such Objection.

The Special Master predicated his conclusion of estoppel primarily on testimony of J. D. Amend. If any estoppel arose, and it is earnestly urged that none did arise, it would have had to arise as a result of testimony of J. D. Amend and Roy Bulls. The substance of J. D. Amend's testimony, when viewed in its most favorable light of the Special Master's Findings, is that

at approximately December 19, 1962, he told Roy Bulls that he, Amend, didn't want to further carry an interest in the Wilbanks Well, that if Tri-State didn't come up with the money, or whoever was supposed to furnish the check, that he wanted to know it, that he had some other people he thought would buy the interest [TR. 17, 18—March 24 hearing]; that prior to December 20 he had never been informed by Baker & Taylor Drilling Co., or anyone else, that the drilling costs for the Nusbaum Well had all been paid; that he didn't know whether all the drilling costs were ever paid [TR. 13—March 24 hearing]; that Amend told Bulls that they were supposed to pay $60,000.00 and that he would notify Amend whether he got the checks or not, that he later had a conversation with Bulls by telephone in which Bulls told him that "he had received the third check in the amount of $20,000.00, or a total of $60,000.00" [TR. 17, 18—March 24 hearing]; that the reason why he told Bulls that if the $60,000.00 was not paid he wanted to know about it was that he didn't want to carry "that interest myself unless it was paid off by those people, that he wanted to sell the interest elsewhere," and that Bulls told him he would let him know when he received checks [TR. 19, 20—March 24 hearing]; that after he received the call that the money had been received, he had no further conversation with Bulls about it [TR. 28—March 24 hearing]. In the conversation which Amend had with Bulls there wasn't any conversation as to application of payments [TR. 55, 56—March 24 hearing]. At the time Amend handed Bulls the check he didn't know of any other indebtedness which Tri-State Petroleum owed Baker & Taylor [TR. 72—March 24 hearing]. Bulls never advised Amend that the three checks had been applied to some pre-existing indebtedness [TR. 72—March 24 hearing].

At page 92 *et seq.* of the Transcript of July 1 hearing, J. D. Amend testified to the conversation with Bulls substantially as above.

J. D. Amend testified by his deposition on March 19, 1964, which deposition was introduced and received in evidence *in toto,* merely that he had delivered the one check and then asked Roy Bulls to let him know if this money came in because he wanted to sell the interest to someone else [Amend Depo. 64] and testified that he asked him "to let me know if he received $60,000.00 for that well" and that later Bulls called him that he had received $60,000.00 when he got the last check [Amend Depo. 64]. He then asked to correct his deposition, testifying "I said for that well. The well itself was never discussed. It was just presumption on my part that the $60,000.00 was for this well" [Amend Depo. 65].

In the interest of brevity and length of brief, the testimony of J. D. Amend with respect to his conversations with Roy Bulls is set out and quoted in Appendix Exhibit 10.

While there is some divergence between the testimony of Amend and Bulls, it is recognized that on those items of testimony at which there is divergence this Court must view the overall testimony in its light most favorable to the Findings of Fact in the court below. The testimony of Roy Bulls, as regards the conversation and what happened between him and J. D. Amend, is likewise set out in the Appendix as Appendix Exhibit 11.

While, as hereinafter discussed, the Findings of Fact by the Special Master, upon which he purported to predicate his Conclusions and Order of estoppel, are clearly wrong as is demonstrated by the testimony of J. D. Amend and Roy Bulls supplied as Appendix Exhibits

9 and 10 respectively, even under the Special Master's Findings of Fact, if permitted to stand, as a matter of law no estoppel arose as against Baker & Taylor Drilling Co. with respect to or on account of the manner in which it made any application of payments.

The Supreme Court of Texas (1952) in *Gulbenkian v. Penn,* 151 Tex. 412, 252 S.W. 2d 929, holds:

> " 'In order to constitute an equitable estoppel or estoppel in pais there must exist a false representation or concealment of material facts; it must have been made with knowledge, actual or constructive, of the fact; the party to whom it was made must have been without knowledge or the means of knowledge of the real facts; it must have been made with the intention that it should be acted on; and the party to whom it was made must have relied on or acted on it to his prejudice.' "

22 Tex. Jur., Sec. 8, pages 668, 669; and 31 C.J.S., Sec. 67, page 402, each state the rule almost verbatim as above quoted.

While it is deemed that as to the situation here involved with respect to claimed estoppel is to be measured by the Texas law, the California rule as to elements of estoppel is substantially as the Texas rule. See *California Cigarette Con. Inc. v. City of Los Angeles* (S. Ct. Cal.), 350 P. 2d 715; and *Hampton v. Paramount Pictures* (S. Ct. of Cal.), 279 F. 2d 100.

In *Rice v. Brown,* 296 S.W. 495 (Com.App. 1927), the court at page 496 states:

> "The principles governing the application of payments are well known and easy of statement. First, the debtor has the right to make application of his payments, but in the event he fails to make such application, the creditor then may do so. In the event neither party makes application of the payments the court will apply them."

In *First National Bank v. International Sheep Co.,* 29 S.W. 2d 513 (CCA. writ refused 1928) it was held that the rule above quoted is well settled. See also *Palm v. Johnson,* 255 S.W. 1007 (CCA), to the same effect.

In *Carey v. Ellis,* 46 S.W. 2d 1012 (CCA 1932), the rule as to right to make application of payment is stated as above quoted, with the court further holding and stating:

> "It is only when neither party has exercised the right of appropriation that the court may assume to make appropriation for the parties."

It is further to be noted in this case that the trial court found that it was the intention of appellees to apply the partial payment to the settlement of the note, but that inasmuch as the appellants were ignorant of this intention the same could, therefore, not affect them.

In *Shonaker v. Loan & Investment Co.,* 8 S.W. 2d 566 (CCA writ refused 1928), debtor owed a note and an item not so evidenced. The debtor testified he thought a $30.00 payment was to be applied on the note, but did not contend that he specifically directed that the installment be applied on the note. On this point the court said:

> "That being true the contractor being entitled to payment for extras and also payment on the note under the same contract was authorized in the absence of specific direction as to application of payment to apply it in payment of either of the indebtednesses held by him."

In the *City National Bank v. Eastland County,* 12 S.W. 2d 662 (CCA 1928), it is said:

> "Since the parties applied the payments no application by the court is necessary, *as the court makes application of payment only when parties have failed to do so.*"

The first sentence of Sec. 35 of 44 Tex. Jur. 2d 689 correctly states the rule:

> "Neither the creditor nor the court can apply payments by one debtor to the payment of another, without the debtor's consent."

Texas Jurisprudence, in support of that rule, cites the case of *Rodgers-Wade Furniture Co. v. Wynn,* 156 S.W. 340 (CCA). The case states the rule:

> "A creditor may elect to apply the payment to any debt of the debtor or the law may apply it for him, but the creditor in the absence of an agreement, express or implied, cannot apply the money to the satisfaction of a debt of a third person; nor, of course, would the law ever so apply it."

In *Gourley v. Iverson Tool Co. et al.,* 186 S.W. 2d 726 (CCA, writ refused 1945) it was held that a third party, not the debtor or the creditor, had no right to direct application to be made of payments.

Section 49, page 706, 44 Tex. Jur. 2d, states the rule:

> "Third persons cannot ordinarily control the application of payment by either the debtor or the creditor and neither the debtor or the creditor is required to apply them so as to benefit any third person."

In support of the rule stated, Texas Jurisprudence cites *Scott v. Cox,* 70 S.W. 802 (Tex. Civ. App.); *Peck v. Powell,* 259 S.W. 640 (Tex. Civ. App.); and *Nelson Manufacturing Co. v. Wallace,* 66 S.W. 2d 505 (Tex. Civ. App.). All of such cases support the quoted text.

In *Peck v. Powell,* 259 S.W. 640 (CCA), the court states rules as follows:

> *"The rule is further stated that third persons cannot control the application of a payment by either*

the debtor or the creditor, and that neither the debtor nor the creditors need apply the payment in such manner as to benefit any third persons."

While it is recognized that *Peck v. Powell* was reversed on other grounds, we, as do the authors of Texas Jurisprudence, think it states the correct rule, and the rules stated were not reversed.

Wischkaemper v. Massey, 70 S.W. 2d 771 (Tex. Civ. App. 1934), states the rule material to this proceeding:

"The rule is that where a debtor is alone liable on one debt and jointly liable upon another, a payment by him or for him should be applied to his individual debt."

In *Fort Worth & D. C. Ry. Co. v. Read Bros. & Montgomery,* 154 S.W. 1021 (Tex. Civ. App.) the court held:

"Certainly a creditor had not the privilege of applying a payment made by his debtor to a debt which did not exist at the time the payment was made, but which was later incurred, in the absence of some special agreement to that effect."

It is earnestly urged that under the testimony and even under the Special Master's Findings of Fact, if the Findings are permitted to stand, when same are measured by the legal test for estoppel, same as a matter of law simply do not constitute a basis for estoppel.

It is earnestly urged that under no conceivable theory could an estoppel arise against the application by Baker & Taylor of Check No. 127 because it was received by Baker & Taylor Drilling Co. from Tri-State Petroleum, Inc. on December 13, 1962 [R. 111—TR. March 24 hearing] and deposited by Baker & Taylor Drilling Co. on December 13, 1962 [Baker & Taylor Ex. E; TR.

113—March 24 hearing]. The Special Master found that that check was received and deposited by Baker & Taylor Drilling Co. on December 13, 1962 [R. 183]. The check was paid by the drawee bank on December 18, 1962 [TR. 112—March 24 hearing]. The incidents upon which the Special Master, and ultimately the District Court through approval of the Special Master's Report, predicated the finding and conclusion of estoppel occurred, without doubt or possible contradiction, after the receipt, deposit and application of Check No. 127. The receipt which J. D. Amend received for Check No. 142 is dated December 19, 1962. That receipt fixes as the date of the conversation between Amend and Bulls, upon which the Special Master predicated his conclusion and order of estoppel a date after Check No. 127 had been received, applied, deposited and paid by the drawee bank. That receipt is attached as Appendix Exhibit 12.

While the Special Master in Finding of Fact XII finds that the check dated December 19, 1962 "was received and deposited on December 13, 1962, or four (4) days prior to its authorized date"; [R. 183] and concludes in Conclusion of Law XIV that Baker & Taylor Drilling Co. had no authority to cash that check prior to December 17, 1962, [R. 194]; *there is absolutely no evidence* of any limitation or restriction on Baker & Taylor as regards deposit of such check. It is established by evidence not contradicted that such check was not paid by the drawee bank until December 18, 1962 [TR. 18—March 24-25 hearing; testimony of Don Bowie TR. 111, 112—March 24-25 hearing; and check, Trustee's Ex. 7]. The check was drawn on Greenfield

State Bank of Bakersfield, California. It was deposited in The First National Bank of Amarillo, Texas [Deposit Slip Baker & Taylor Ex. E, entered p. 13 TR. March 24 hearing]. Banking channels are merely a vehicle of transit for presentation of the check to the payee bank. The fact that the check was deposited in The First National Bank of Amarillo, Texas, for ultimate presentation to Greenfield State Bank, Bakersfield, California, for payment in no degree or regard limits or diminishes the fact that the amount of the check was applied to the indebtedness of Tri-State on account of its contract for the drilling of the Nusbaum Well before J. D. Amend's conversation with Roy Bulls, which was the beginning of the sequence of events upon which the Special Master and the court predicated their conclusion and holding of estoppel. There was no limitation in any regard placed upon Baker & Taylor Drilling Co. either at law or in fact as to the time it might transmit the check through banking channels for presentation to the drawee bank for payment.

Section 186 of the Negotiable Instruments Act, Article 5947, Sec. 186, Texas Revised Civil Statutes, provides that the check must be presented within a reasonable time after its issuance or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay.

It is the law in Texas that where a check is received as a condition payment, payment becomes absolute and relates to the date of delivery of the check when the recipient of the check actually cashes the check. Two Supreme Court cases which are authority on this point are:

Texas Mutual Life Ins. Ass'n. v. Tolbert, 136 S.W. 2d 584, 134 Tex. 419 (1940); and *Muldrow v. Texas Frozen Foods,* 299 S.W. 2d 275, 157 Tex. 39 (1957). The principles of the two Texas Supreme Court cases are encompassed by and set out in 70 C.J.S. 235, Sec. 24, and in 40 Am. Jur. 775, Sec. 86.

V.
Conclusion.

Baker & Taylor Drilling Co. submits that the Special Master and the District Court were without jurisdiction of subject matter involved and were without jurisdiction of Baker & Taylor Drilling Co. as to any matter. Further that they were particularly without jurisdiction to determine rights between Baker & Taylor Drilling Co. and J. D. Amend and particularly without jurisdiction to enjoin actions by Baker & Taylor Drilling Co. against J. D. Amend as they sought to do.

Without admitting or recognizing any jurisdiction of the Special Master or Court to act but denying jurisdiction as above urged, Baker & Taylor Drilling Co. submits that if they did have jurisdiction, nevertheless under the uncontradicted evidence and even under the Special Master's findings of fact, as a matter of law Baker & Taylor Drilling Co. was not estopped from applying the two $20,000.00 checks as it did.

Baker & Taylor Drilling Co. prays that the judgment of the District Court denying the objection of Baker & Taylor Drilling Co. to the findings report recommendation and order of the Special Master, overruling same, adopting the findings of fact and conclu-

sions of law of the Special Master and adopting the recommended order of the Special Master be reversed and that this Honorable Court hold, decree and order that the Special Master and the District Court and each of them were without jurisdiction of the gas well on Section 2, Block 1, H&GN Survey in Hansford County, Texas, and the lease under which drilled, alternatively were without jurisdiction of the 20% interest thereof which unquestionably was owned by J. D. Amend; and were without jurisdiction of Baker & Taylor Drilling Co. to adjudicate with respect to its rights as to said property, were without jurisdiction to determine rights between Baker & Taylor Drilling Co. and J. D. Amend and were without jurisdiction to enjoin action by Baker & Taylor Drilling Co. against J. D. Amend, and that this Honorable Court order and decree that all adjudication by the Special Master and the Court below and Judge thereof, as to rights between Baker & Taylor Drilling Co. and J. D. Amend and injunctive restraint as to rights and actions between Baker & Taylor Drilling Co. and J. D. Amend and property of J. D. Amend, is ineffective. Alternatively, in the event this Honorable Court finds or holds that the Special Master and District Court, or either of them, has jurisdiction of the subject matter and persons to adjudicate with respect to the subject matter and persons with respect to which they sought to adjudicate, it hold, decree and order that Baker & Taylor Drilling Co. was not estopped to apply the $20,000.00 check of Tri-State Petroleum, Inc. to the debt of Tri-State Petroleum, Inc., as it did. That this Honorable Court render judgment accordingly as above prayed for, alternatively that this Court remand

to the District Court with instructions accordingly, Baker & Taylor Drilling Co. prays for all other relief to which it is entitled.

Respectfully submitted,

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Certificate.

We certify that, in connection with the preparation of this Brief, we have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in our opinion, the foregoing Brief is in full compliance with those rules.

DAVID M. GARLAND.

INDEX TO APPENDIX

APPENDICES.

APPENDIX EXHIBIT 1.

Record Reference to Manner and Place at Which the Questions Involved Are Raised.

Question No. (1) is raised by and under:

(a) The Special Master's Conclusion of Law I, his Conclusion of Law III (R 190), his Conclusion of Law X (R 192), his Conclusion of Law XIII (R 193), his Finding of Fact XXV (R 188, 189), his Finding of Fact XXVI (R 189), his Finding of Fact XXVII (R 189), his Finding of Fact XXVIII (R 189, 190), the Special Master's Order of October 26, 1964 (R 327-329) and particularly the sixth paragraph thereof, reading as follows:

> "IT IS FURTHER ORDERED that Baker & Taylor Drilling Company, its assignee, or any one acting for or in its behalf, are estopped, and are hereby enjoined and restrained from hereafter filing, prosecuting, or taking any action in any court of any jurisdiction, other than before this Court, against J. D. Amend or Tri-State Petroleum, Inc., or the Trustee in Bankruptcy of Tri-State Petroleum, Inc., debtor, based upon its claim growing out of the drilling of the gas well mentioned and described in these proceedings."

(b) Baker & Taylor Drilling Co.'s Objection and Exception III to proposed Findings of Fact (R 158, 159); Baker & Taylor Drilling Co.'s Objection XIV to proposed Findings of Fact (R 162); Baker & Taylor Drilling Co.'s Objection No. XV to proposed Findings of Fact (R 162); Baker & Taylor Drilling Co.'s Objection No. XVI to proposed Findings of Fact (R 163); Baker & Taylor Drilling Co.'s Objection No. XVIII(2) to proposed Conclusions of Law (R 163);

Baker & Taylor Drilling Co.'s Objection No. XVIII(4) and (6) to the proposed Conclusions of Law (R 164); Baker & Taylor Drilling Co.'s Objection No. XVIII(9) and (10) to the Special Master's proposed Conclusions of Law (R 165, 166).

(c) Baker & Taylor Drilling Co.'s Objection I to the Conclusions, Findings of Fact and Order of the Special Master (R 203); Baker & Taylor Drilling Co.'s Objection VIII and Baker & Taylor Drilling Co.'s Objection No. XX to the Special Master's Finding No. XXV (R 212); Baker & Taylor Drilling Co.'s Objection No. XXI to the Special Master's Finding of Fact No. XXVI (R 213); Baker & Taylor Drilling Co.'s Objections Nos. XXIIa, XXIII, XXIV and XXV to the Special Master's Findings of Fact (R 214, 213); Baker & Taylor Drilling Co.'s Objections Nos. XXVII(1), (2), (3), (4), (5)(a), (6), (7), (9) and (10) to the Special Master's Conclusions of Law (R 217, 218); Baker & Taylor Drilling Co.'s Objection XXVII(5) to the Special Master's Conclusions of Law (R 219); Baker & Taylor Drilling Co.'s Objection No. XXVII(6) to the Special Master's Conclusions of Law (R 220); Baker & Taylor Drilling Co.'s Objection No. XXVII(7) to the Special Master's Conclusions of Law (R 220); Baker & Taylor Drilling Co.'s Objection No. XXVII-(10) to the Special Master's Conclusions of Law (R 221, 222); Baker & Taylor Drilling Co.'s Objection No. XVIII(a), (b), (c), (d) and (e) to the Order of the Special Master (R 223); Baker & Taylor Drilling Co.'s Objections XXX, XXXI, XXXII and XXXIII to the Special Master's Order (R 224, 226)

(d) The order of the District Court denying and overruling the Objections and Exceptions of Baker & Taylor Drilling Co. to the Findings, Report, Recommendations of the Special Master and adopting the Find-

ings of Fact and Conclusions of Law and Order of the Special Master as the order of the trial court. (R 233, 234)

Each and all of the objections and exceptions urge lack of jurisdiction of the Special Master to determine rights and liabilities as between J. D. Amend and Baker & Taylor Drilling Co.

Question No. (2) is raised by and under the same matters as Question No. (1) is raised, and the Record references with respect to Question No. (2) are the same as set out above under Question No. (1).

Question No. (3) is raised by and under the same matters as Question No. (1) is raised, and the Record References with respect to Question No. (3) are the same as set out above under Question No. (1).

Question No. (4) is raised by and under the same matters as Question No. (1) and the Record references with respect to Question No. (4) are the same as set out above under Question No. (1).

Question No. (5) is raised by and under:

(a) Baker & Taylor Drilling Co.'s plea of lack of jurisdiction (R 141 et seq.)

(b) Baker & Taylor Drilling Co.'s Objection No. XVI to the Special Master's proposed Findings of Fact (R 163); Baker & Taylor Drilling Co.'s Objection No. XVIII (1), (3), (4), (6) and (8) to the Special Master's proposed Conclusions of Law No. II (R 163-164); Baker & Taylor Drilling Co.'s Objections Nos. A and B to the Special Master's proposed Order(R166).

(c) The Special Master's Conclusion that the objection to the summary jurisdiction should be overruled (R 174); the Special Master's Finding of Fact II (R 176); the Special Master's Conclusion of Law I (R 190).

(d) The Special Master's Order of October 26, 1964 (R 327-329).

(e) Baker & Taylor Drilling Co.'s Objection No. I to the Conclusions, Findings of Fact and Order of the Special Master (R 203); Baker & Taylor Drilling Co.'s Objection No. XX to the Special Master's Findings of Fact (R 212); Baker & Taylor Drilling Co.'s Objection No. XXI to the Special Master's Findings of Fact (R 213); Baker & Taylor Drilling Co.'s Objection No. XXIV to the Special Master's proposed Findings of Fact (R 214); Baker & Taylor Drilling Co.'s Objection No. XXV, to the Special Master's proposed Findings of Fact (R 215); Baker & Taylor Drilling Co.'s Objection No. XXVII(1), (3), (4), (5)(a), (6), (7), (9) and (10) to the Special Master's Conclusions of Law (R 217-222); Baker & Taylor Drilling Co.'s Objection No. XXVIII(a) and (b) to the Order of the Special Master (R 223); Baker & Taylor Drilling Co.'s Objection No. XXX to the Order of the Special Master (R 224); Baker & Taylor Drilling Co.'s Objection No. XXIX to the Special Master's Order (R 224); Baker & Taylor Drilling Co.'s Objection No. XXXI to the Order of the Special Master (R 225); Baker & Taylor Drilling Co.'s Objection No. XXXII to the Special Master's Order (R 226).

(f) The order of the District Court denying and overruling the Objections and Exceptions of Baker & Taylor Drilling Co. to the Findings, Report, Recommendations of the Special Master and adopting the Findings of Fact and Conclusions of Law and adopting the Order of the Special Master as the order of the trial court. (R 233, 234)

Question No. (6) is raised under and by:

(a) Baker & Taylor Drilling Co.'s plea of lack of jurisdiction (R 114); Baker & Taylor Drilling Co.'s Objection No. XVI to the Special Master's proposed Findings of Fact (R 163); Baker & Taylor Drilling Co.'s Objection No. XVIII(1) to the Special Master's proposed Findings of Fact (R 163); Baker & Taylor Drilling Co.'s Objections XXIII(3), (4) and (6) to the Special Master's proposed Conclusions of Law (R 164); Baker & Taylor Drilling Co.'s Objections to the proposed Order of the Special Master (R 166);

(b) The Special Master's Conclusion that the objection to the summary judgment of the Bankruptcy Court should be overruled (R 174); the Order of October 26, 1964, by the Special Master (R 327-329)

(c) Baker & Taylor Drilling Co.'s Objection No. I to the Special Master's Report, Findings of Fact and Order (R 203); Baker & Taylor Drilling Co.'s Objection No. XX to the Special Master's Findings of Fact (R 212); Baker & Taylor Drilling Co.'s Objection No. XXI to the Special Master's Findings of Fact (R 213); Baker & Taylor Drilling Co.'s Objection No. XXIV to the Special Master's Findings of Fact (R 214); Baker & Taylor Drilling Co.'s Objection No. XXVII (1), (2), (3), (4), (5)(a), to the Conclusions of Law of the Special Master (R 217-219); Baker & Taylor Drilling Co.'s Objections Nos. XXVII(6) and (7) to the Conclusions of Law of the Special Master (R 220); Baker & Taylor Drilling Co.'s Objection XXVII(10) to the Conclusions of Law of the Special Master (R 221,222); Baker & Taylor Drilling Co.'s Objection No. XXVIII-

(a) and (b) to the Special Master's Order (R 223); Baker & Taylor Drilling Co.'s Objection No. XXIX-(b) and (c) to the Special Master's Order (R 224); Baker & Taylor Drilling Co.'s Objection No. XXX to the Special Master's Order (R 224, 225); Baker & Taylor Drilling Co.'s Objection No. XXXI(a) to the Special Master's Order (R 225); Baker & Taylor Drilling Co.'s Objection No. XXXII to the Special Master's Order (R 226).

(d) The order of the District Court denying and overruling the Objections and Exceptions of Baker & Taylor Drilling Co. to the Findings, Report and Recommendations of the Special Master and adopting the Findings of Fact, Conclusions of Law and Order of the Special Master as the order of the trial court.

Question No. (7) is raised under and by the same matters as are set out under Questions Nos. (5) and (6), and the Record references with respect to Question No. (7) are the same as with respect to Questions Nos. (5) and (6).

Question No. (8) is raised under and by:

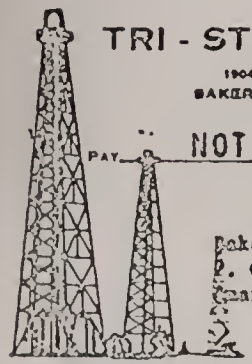
(a) Baker & Taylor Drilling Co.'s Objection Nos. I, II, III, IV, V, VI, VII, VIII to the Special Master's proposed Findings of Fact (R 157-161); Baker & Taylor Drilling Co.'s Objection XVIII(9) to the Special Master's proposed Conclusions of Law (R 163, 165-166).

(b) The Special Master's Findings of Fact Nos. V, VI, VIII, XII, XIII, XVI and XVII (R 178, 179, 181, 183, 184, 185).

(c) The Special Master's Order of October 26, 1964 (R 327-329).

(d) Baker & Taylor Drilling Co.'s Objection Nos. VI, VII, VIII, XI, XII, XIII, XXII to the Special Master's Findings of Fact (R 204); Baker & Taylor Drilling Co.'s Objections Nos. XXVII(5)(b), (5)(d), 10 and 11 to the Special Master's Conclusions of Law (R 217, 219, 221, 222); Baker & Taylor Drilling Co.'s Objections Nos. XXVIII(c) and (d) to the Special Master's Order (R 223, 224); Baker & Taylor Drilling Co.'s Objection XXXI to the Special Master's Order (R 225, 226).

(e) The order of the District Court denying and overruling the Objections and Exceptions of Baker & Taylor Drilling Co. to the Findings, Report and Recommendations of the Special Master and adopting the Findings of Fact, Conclusions of Law and Order of the Special Master as the order of the trial court. (R 233, 234).



TRI - STATE *Petroleum, Inc.*

1904 TRUXTUN AVENUE
BAKERSFIELD, CALIFORNIA

90-1891
1222

No 00127

PAY NOT OVER 20000 DOLS 00 CTS

DATE Dec. 17, 1962 AMOUNT 20,000.00

Baker & Taylor Drilling Co.
P. O. Box 2743
Amarillo, Texas

BY _____

BY _____

⑈1222⑆0891⑈ 02 4578⑈0⑈

HEAD OFFICE - GREENFIELD STATE BANK - BAKERSFIELD, CALIFORNIA

Depos 12-13-62

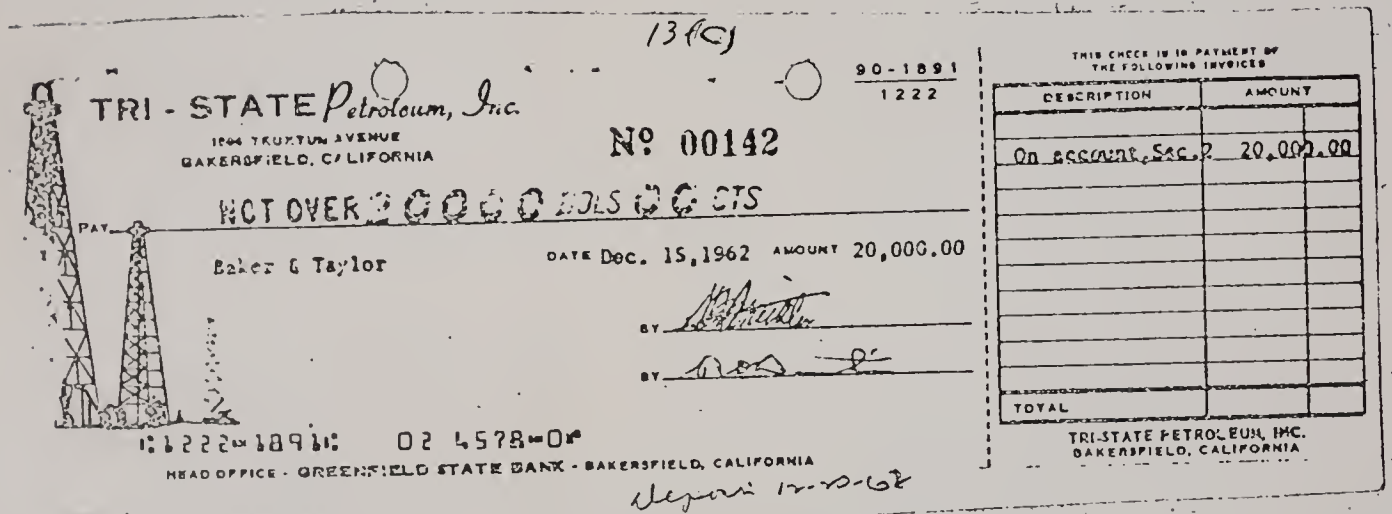
THIS CHECK IS IN PAYMENT OF THE FOLLOWING INVOICES

DESCRIPTION	AMOUNT	
L		
TOTAL		

TRI-STATE PETROLEUM, INC.
BAKERSFIELD, CALIFORNIA

APPENDIX EXHIBIT 2

APPENDIX EXHIBIT 3



13(C)

TRI - STATE Petroleum, Inc.
1904 TRUXTUN AVENUE
BAKERSFIELD, CALIFORNIA

90-1891
1222

No 00142

PAY NOT OVER TWENTY THOUSAND DOLS 00 CTS

Baker & Taylor

DATE Dec. 15, 1962 AMOUNT 20,000.00

BY

BY

THIS CHECK IS IN PAYMENT OF THE FOLLOWING INVOICES

DESCRIPTION	AMOUNT	
On account Sec. 2	20,000	00
TOTAL		

TRI-STATE PETROLEUM, INC.
BAKERSFIELD, CALIFORNIA

1:1222:1891: 02 4578=0

HEAD OFFICE - GREENFIELD STATE BANK - BAKERSFIELD, CALIFORNIA

Deposit 12-20-62

1222

1904 TRUXTUN AVENUE
BAKERSFIELD, CALIFORNIA

Nº 00156

THE SUM 20000 DOLS 00 CTS.

PAY

DATE Dec. 20, 1962 AMOUNT 20,000.00

Baker & Taylor

BY

BY

⑈1222⑈ ⑆891⑆ 02 4578⑈0⑈

HEAD OFFICE - GREENFIELD STATE BANK - BAKERSFIELD, CALIFORNIA

APPENDIX EXHIBIT 4

BAKER & TAYLOR DRILLING COMPANY

DRILLING CONTRACT, AUGUST 24, 1962 - Tri-State Petroleum Company

NUSBAUM - SECTION 54, BLOCK 4T, T & NO, HANSFORD COUNTY, TEXAS

SPUD 8-31-62 - PERFORMANCE OF WORK COMPLETED 10-3-62 09-043

VENDOR TRANSACTIONS				B & T REFERENCE			CHECKS RECEIVED				APPLICATION		
NAME	INVOICE NUMBER	INVOICE DATE	AMOUNT	G/L MONTH	INV. NO. OR J. E. NO.	CUSTOMER NUMBER	MAKER	ISSUED TO	CK. NO.	CHECK DATE	DEPOSIT DATE	DR.	CR.	BAL.
				9-62	62-17	912	Tri-State	B&T	3154	8-24-62	9-21-62		30,000.00	(30,000.00)
Southwell Supply	10-141	9-25-62	279.50	10-62	6221	912								
Southwell Supply	9-766	9-26-62	140.52	9-62	6221	912						432.85		(29,567.15)
Southwell Supply	9-671	9-28-62	12.83	9-62	6221	912								
Schlumberger	35865	9-28-62	3,390.96	1-63	63299	912						3,390.96		(26,176.19)
Rainbo Service	80680	9-30-62	275.00	10-62	62263	912								
Milton Ford & Sons	4195	10-1-62	86.30	11-62	62263	912						476.30		(25,699.89)
K & S Welding	215	10-1-62	15.00	10-62	62263	912								
Phil A. Cornell, Inc.	3800P	10-15-62	54.66	10-62	62200	912						54.66		(25,645.23)
				10-62	62194	912						67,940.63		42,295.40
				10-62	66-10	912	Tri-State	Amend	3418	10-22-62	10-26-62		5,000.00	37,295.40
				11-62	75-03	912	Tri-State	Amend	3438	10-29-62	11-2-62		5,000.00	32,295.40
Schlumberger	35865	9-28-62	(2,258.77)	5-63	63024CM	912							2,258.77	30,036.63
				12-62	89-13	912	Tri-State	B & T	127	12-17-62	12-18-62		20,000.00	10,036.63
				12-62	89-15	912	Tri-State	B & T	156	12-20-62	12-27-62		10,036.63	-0-

THE CONTRACT PROVIDES FOR THESE TERMS AND DUE DATES: ← → CHECKS WERE RECEIVED FOR PAYMENT AS FOLLOWS:

CONDITION	AMOUNT	TO BE PAID BY:
Escrow before spud	30,000.00	Prior to 8-31-62
Due 30 days after completion of drilling.	30,000.00	Due on 11-2-62
Daywork 30 days after completion of drilling	7,940.63	Due on 11-2-62
Third party charges - 30 days	2,096.00	Due on 11-2-62
	70,036.63	

MAKER	CK. NO.	CK. DATE	AMOUNT	REMARKS:
Tri-State	3154	8-24-62	30,000.00	None
Tri-State	3418	10-22-62	5,000.00	~~19 days past due~~
Tri-State	3438	10-29-62	5,000.00	~~26 days past due~~
Tri-State	127	12-17-62	20,000.00	~~45~~ 75 days past due
Tri-State	156*	12-20-62	10,036.63	48 days past due
			70,036.63	

* This Check, No. 156, for $20,000.00, was applied as follows:

To Nusbaum, Section 54	10,036.63
To Wilbanks - Section 2	9,963.37
	20,000.00

* Note: This check is dated 12-20-62 which is twoo days prior to the completion of the Wilbanks well - Under the Wilbanks contract, no money is due until January 21, 1963 - Pre-payment, of course, is acceptable.

Appendix Exhibit 5

BAKER & TAYLOR DRILLING COMPANY

DRILLING CONTRACT, DECEMBER 1, 1962 - J. D. AMEND

WILBANKS - SECTION 2, BLOCK 1, H & GN SURVEY, HANSFORD COUNTY, TEXAS

~~SPUD 12-2-62 - PERFORMANCE OF WORK COMPLETED 12-22-62~~

BAKER & TAYLOR REFERENCE						CHECKS RECEIVED				APPLICATION		
DATE	G/L MONTH	INVOICE NUMBER	J. E. NUMBER	CUSTOMER NUMBER	MAKER	ISSUED TO	CK. NO.	CHECK DATE	DEPOSIT DATE	DR.	CR.	BAL.
1-10-63	12-62	62292	92-20	030						$57,200.00		57,200.00
12-26-62	12-62	62276	---	030							1,365.00	55,835.00
12-20-62	12-62	---	89-14	912	Tri-State	B&T	142	12-15-62	12-20-62		20,000.00	35,835.00
12-27-62	12-62	---	89-15	912	Tri-State	B&T	156	12-20-62	12-27-62		9,963.37	25,871.63

THE CONTRACT PROVIDES FOR THESE TERMS AND DUE DATES:

CONDITION	AMOUNT	TO BE PAID BY:
Turnkey Contract (-800.00 + DST)	57,200.00	On January 21, 1963

CREDITS WERE RECEIVED FOR PAYMENT AS FOLLOWS:

MAKER	CK. NO.	CK. DATE	AMOUNT	REMARKS:
B&T GM.		12-26-62	1,365.00	Oil from O. D. C. - Section 56
Tri-State	00142	12-19-62	20,000.00	Prepayment directed by Tri-State
Tri-State	00156*	12-20-63	9,963.37	Prepayment
	TOTAL PAID		31,328.37	
	BALANCE		25,871.63	- PAST DUE

* This Ck. #156 for $20,000.00 was applied as follows:

TO: Nusbaum - Section 54	10,036.63	- because of past due balance(1)
TO: Wilbanks - Section 2	9,963.37	- prepayment on well being drilled
	20,000.00	

(1) See reference on Nusbaum, Section 54, detail analysis sheet

Appendix Exhibit C

Feb. 11, 1963

RE: Sec. 2, Block 1,
H&GN, Hansford Co.,
Texas

Mr. H. F. Schlittler
1904 Truxton Ave.
Bakersfield, California

Dear Foy:

This letter will confirm our agreement as to the Cleveland Gas Well on the above captioned Section.

You will be assigned a 3/4 interest in this well subject to the customary 1/8 royalty, a 1/32 override to Phillips Pet. Co. and a 1/92 (one thirtysecond) override to the people from whom the deal was obtained. This assignment will be made to you or by the order of you when the well is finally completed and all expenses have been taken care of by each of us as to the percentage which we own.

The agreement with Phillips is enclosed so you will have a thorough knowledge of the transaction and in case you are successful in making a deal with some one on Sec. 2 and also the S/2 of Sec. 56, Blk 4, T&NO, Hansford County, you can present a true picture of the lease.

This deal will have additional good locations such as a lower morrow on Sec. 2 and an excellent Upper morrow on 56. There are also additional locations for the Marmaton in both leases and especially on Sec. 56. The Phillips well in Sec. 2 made over 6,000,000 cu ft of Gas natural and was ruined when treated. This zone is a certainty.

The well is cleaning up and we will try to get a potential in the next 4 or five days. I have already contacted Northern Natural and we should get a connection in the near future.

In line with our telephone conversation, it will be to our mutual advantage to sell this well and our additional interest in 56 so that we can proceed with the development of the BA farmout.

Regards,

_____.
J. D. Amend

APPENDIX EXHIBIT 7

BAKER & TAYLOR DRILLING COMPANY
REFERENCE INDEX ACCOUNT #107 FOR
J. O. AMENO - 030 & TRI-STATE PETROLEUM - 912

WELL NAME		REFERENCE	ACCT. NO. 107 GENERAL LEDG. ACCT. MONTH	CUSTOMER NUMBER	INVOICE OR DEPOSIT DATE	DEBIT OR CREDIT AMOUNT	AMOUNT OF BALANCE	J. E. PAGE NO.	GENERAL Ledg. (Mo.) PAGE #	COMPOSITE G. LEDGER PAGE #
		REFERENCE							INDEX	
#056 O. D. C.	B62098	JE 3119	June 1962	030	7-10-62	57,220.95		031	June 1	20
		JE 2609	June 1962	030	6-5-62	(11,000.00)		026	June 1	8
		JE 2609	June 1962	030	6-25-62	(9,000.00)		026	Jurle 1	8
		JE 3504	July 1962	030	7-10-62	(37,220.95)	-00-	035	July 1	9
#054 Nusbaum		B 62194	Oct. 1962	912	10-25-62	67,940.63			Oct. 2	24
		B 62200	Oct. 1962	912	11-6-62	54.66			Oct. 2	24
			(Sept. 1962	912		146.37)			Sept. 2	25
			(Sept. 1962	912		13.36)			Sept. 2	25
			(Oct. 1962	912		279.50)			Oct. 2	24
			(Disc.			(6.38))				
		B 62211		912	11-7-62	432.85				
			(Oct. 1962	912		275.00)			Oct. 2	24
			(Oct. 1962	912		15.00)			Oct. 2	24
			(Nov. 1962	912		186.30)			Nov. 3	23
		B 62263	(	912	12-18-62	476.30.)				
		B 63299	Jan. 1963	912	1-22-63	3,390.96			Jan. 1	17
		CM 63024	May 1963	912	5-7-63	(2,258.77)			May 3 (63-64)	23
		JE 5507	Sept. 1962	912	9-21-62	(30,000.00)		055	Sept. 2	11
		JE 7503	Nov. 1962	912	11-2-62	(5,000.00)		075	Nov. 3	14
		JE 6610	Oct. 1962	912	10-26-62	(5,000.00)		066	Oct. 2	12
		JE 8913	Dec. 1962	912	12-13-62	(20,000.00)		089	Dec. 3	16
		JE 8915	Dec. 1962	912	12-27-62	(10,036.63)	-00-	089	Dec. 3	16
#002 Wilbanks	B62292	JE 9220	Dec. 1962	030	1-10-63	57,200.00		092	Dec. 1	14
		CM 62276	Dec. 1962	030	12-26-62	(1,365.00)			Dec. 1	19
		JE 8914	Dec. 1962	912	12-20-62	(20,000.00)		089	Dec. 3	16
		JE 8915	Dec. 1962	912	12-20-62	(9,963.37)	25,871.63	089	Dec. 3	16

APPENDIX EXHIBIT 9.

Quotation From In Re Diversey Bldg. Corp., 86 F.2d 456.

"The question here presented is whether the District Court had the power to release Becklenberg from his guaranty of the old bond issue in consideration of his guaranty of the new bond issue, pursuant to the reorganization plan which had been approved by the court after its acceptance by two-thirds in amount of the allowed and affected claims of each class of creditors, but which had not been accepted by appellants, who were bondholders of the original issue.

This question must be answered in the negative. Section 265 of the Judicial Code (28 U.S.C.A. § 379) provided that the writ of injunction shall not be granted by any federal court to stay proceedings in any state court, except where authorized by a law relating to proceedings in bankruptcy. Our attention has not been directed to any section of the Bankruptcy Act which would authorize the issuance of this injunction. It is quite true that the bankruptcy court has complete jurisdiction of the person and property of the debtor, and may protect that jurisdiction to the fullest extent by injunctive process, but further than this, it can not go. Appellee urges that authority for the injunction is to be found in section 2 (15) of the Bankruptcy Act (11 U.S.C.A. § 11 (15), and section 262 of the Judicial Code (28 U.S.C.A. § 377). Those sections, however, merely invest the court with power to protect its jurisdiction and to enforce its orders which do not exceed the limits of its jurisdiction.

The trouble here is that the court exceeded its jurisdiction with respect to the subject matter before it. Appellants were in no way interfering or threatening to interfere with the court's jurisdiction of the debtor or its

estate, or its lawful reorganization. Their actions and threatened actions were merely in derogation of that part of the plan which proposed to release Becklenberg's guaranty of the original bonds. Their position was sound and the court was without jurisdiction to restrain them in this respect. It is quite true that a continuation of appellants' activities might have frustrated the approved plan, but if so, it was because it was too extensive in its scope. It not only purported to reorganize the debtor's estate by reducing the amount of its debt and interest and extending the time of payment, but it also essayed to reduce the indebtedness of Becklenberg and extend his time for payment. His estate is not subject to reorganization under section 77B, and he can not modify his obligations by the reorganization of other insolvents. The only relief which he may seek under the Bankruptcy Act, with respect to his debts, is to be found under section 74 as amended on June 7, 1934 (11 U.S.C.A. § 202), and the provisions of the act as it existed before that amendment; and he is not entitled to relief under those provisions until he tenders his estate to the bankruptcy court for administration, and establishes the fact that he is insolvent, or is unable to meet his debts as they mature. None of these facts appear, hence the court was without jurisdiction to make the order complained of insofar as it affected the original guaranty of Becklenberg. This question was decided adversely to appellee's present contention by the Second Circuit Court of Appeals in Re Nine North Church Street, Inc., 82 F.(2d) 186. We are in accord with the conclusions therein expressed. They are supported by section 16 of the Bankruptcy Act (11 U.S.C.A. § 34) which provides that the liability of a person who is a co-debtor with, or guarantor, or in any manner a surety for, a bankrupt, shall not be altered by the discharge of such bankrupt.

In support of the order, appellee relies upon Continental Illinois Nat. Bank & Trust Co. v. Chicago Rock Island & P. Railway Co., 294 U.S. 648, 55 S.Ct. 595, 79 L.Ed. 1110. It was there held that the court was warranted in restraining creditors, pending the preparation and submission of a plan of reorganization, from selling collateral deposited by the debtor with the creditors as security for the debtor's obligations, in which it was provided that the creditors might sell the securities upon default in payment by the debtor. We think the case is not in point. The record there disclosed that the fair value of the securities respectively held exceeded the several amounts of the debts, hence there was a valuable equity in the securities which belonged to the debtor and consituted a part of its assets. The restraining order merely served to protect the debtor's assets until a plan could be presented. Here, no such question arises, for the injunction involved related to acts which in no manner interfered with the debtor's assets."

APPENDIX EXHIBIT 10.

Testimony of J. D. Amend as to Conversation With Roy Bulls.

At the hearing of March 24 and 25, 1964 on the Show Cause Order, J. D. Amend testified as follows:

"Q. During the month of December, did you receive a check from Tri-State Petroleum? A. Yes, I did.

Q. On or about what day, do you know? A. It was about the middle of December.

Q. And was that check made payable to you or to someone else? A. It was made payable to Baker & Taylor Drilling Company.

Q. And what did you do with that check? A. I took it to Baker & Taylor and turned it over to Baker & Taylor.

Q. Who in Baker & Taylor's office did you turn it over to? A. I turned that check over to Roy Bulls.

Q. And who is Roy Bulls? A. He is connected with the company, I believe probably as a vice-president. But he is one of the officials of the company.

Q. Do you know whether or not this is the check you turned over to him (indicating)? I am referring to check No. 00142 drawn on the Greenfield State Bank by Tri-State Petroleum, Inc., and signed by Mr. Buntin and Mr. Schlittler, and payable to Baker & Taylor in the sum of $20,000.00. A. Now, there are three of these checks, and the dates on these checks are close together, and I did take one of these checks and turn it over to Baker & Taylor; but as to which one I did, I can't definitely say. I don't recognize which one it was.

Q. Was there a stub on the one you turned over? A. I'm not sure about it."

* * * * *

"Q. Now, at the time you turned that check over to Mr. Bulls, or Baker & Taylor, did you have any con-

versation about the payment of the drilling costs by Tri-State? A. Yes, I did.

Q. And was anyone else present other than you and Mr. Bulls, at the time? A. No, I believe not.

Q. And where was the conversation held? A. It was in the office of Baker & Taylor Drilling Company.

Q. And what was that conversation? Will you relate it? A. We were both aware of some of these checks that hadn't been paid, from Tri-State.

Q. You mean some had bounced? A. Yes; and I told Roy, that is Roy Bulls, that I didn't want to carry a further interest in this well, I couldn't afford to, and that if Tri-State didn't come up with the money, or Mr. Schlittler or whoever was supposed to furnish the checks, that I wanted to know about it, that I had some other people I thought would buy my interest.

Q. Did you tell him how much they were supposed to pay? A. Yes, I did.

Q. What did you tell him? A. $60,000.00; and he told me that he would notify me as to whether he got the checks or not.

Q. Did you later have a conversation with him? A. Yes, I did.

Q. And was it personally or by telephone? A. It was by telephone. He called me and told me that he had received the third check in the amount of $20,000.00, or a total of $60,000.00." (TR March 24-25, 1964 hearing, p. 15 to p. 18)

Q. BY MR. UTLEY: Mr. Amend, was there any particular reason why you told Mr. Bulls if this $60,000.00 was not paid you wanted to know about it? A. Yes, there was. As I just stated, I wanted to do something else with this—

MR. BERRY: If it please the court, I didn't understand that to be a question as to what he told Mr. Bulls.

MR. UTLEY: Well, I think he has answered the question.

Q. Now, did you tell Mr. Bulls what the reason was? A. Yes, I told him.

Q. What did you tell him?

THE SPECIAL MASTER: Just state the conversation between yourself and Mr. Bulls.

THE WITNESS: I told him this, that I didn't want to carry that interest myself, and unless it was paid off by these people that I wanted to sell the interest elsewhere.

Q. BY MR. UTLEY: And then is when he told you he would let you know if the checks — A. He agreed to let me know if and when he received the checks." (TR March 24-25, 1964 hearing, pp. 19 and 20)

"Q. BY THE SPECIAL MASTER: Subsequent to December 20th of 1962, did you have any further conversation with Mr. Bulls with reference to the payment or nonpayment of additional money? A. After I received this call that the monies had been paid, I had no further conversation with him about it and had no —

Q. Wait a minute. After what? A. After I received a telephone call from Mr. Bulls telling me that the $60,000.00 had been paid.

THE SPECIAL MASTER: All right.

THE WITNESS: Now, the date of that is why I say what I do. That might have been after December 20th.

THE SPECIAL MASTER: Let me see the last check.

THE WITNESS: It would be after the last check was received.

MR. UTLEY: The perforation shows the last check was paid on the 4th of January, 1963.

THE WITNESS: My answer then would be there was no further conversation following that check.

THE SPECIAL MASTER: All right." (TR March 24-25, 1964 hearing, pp. 28 and 29)

"Q. What did you deliver to Baker & Taylor for application on that contract from any source? A. I delivered a check signed by Tri-State Petroleum Company in the amount of $20,000.00.

Q. Mr. Amend, introduced this morning as Trustee's Exhibit 5 was a check 00142, which I believe you testified was the $20,000.00 check which you delivered to Baker & Taylor Drilling Company. A. That seems to be it.

THE SPECIAL MASTER: Is that the check — what date?

THE WITNESS: December 15th.

THE SPECIAL MASTER: Yes, dated December 15th.

Q. BY MR. BERRY: Actually, Mr. Amend, at the time that check was delivered to Baker & Taylor Drilling Company, that is the check 00142, it had a stub on it, did it not? A. Well, this shows a stub on it, and I'm sure it did.

MR. BERRY: Mr. Utley, I believe that you introduced that from the deposition this morning, did you not?

MR. UTLEY: Yes, to show that there was a stub

MR. BERRY: Fine, thank you.

Q. Now, Mr. Amend, that is the only payment that you delivered to Baker & Taylor in any regard for application on the contract price with respect to the drilling of the well on Section 2? A. That is the only check that I delivered to them, yes.

Q. Did you receive a receipt for that check, Mr. Amend? A. I possibly did. I don't have the receipt, but I might possibly have received one.

Q. The other two $20,000.00 checks that you were questioned about this morning, if they got to Baker &

Taylor Drilling Company you did not deliver them, did you? A. No." (TR March 24-25, 1964 hearing, pp. 50-51)

"Q. Now, Mr. Amend, do you know or could you determine the date at which you delivered to Baker & Taylor the check No. 00142? A. Wasn't there an exhibit that had that date on the—

Q. There is a receipt, deposition Exhibit No. 12, which— A. Well, that would be the approximate date of it.

Q. December 19, 1962? A. Yes.

MR. UTLEY: That delivery was what date?

MR. BERRY: December 19, 1962." (TR March 24-25, 1964 hearing, p. 53)

"Q. Mr. Amend, counsel for Baker & Taylor Drilling Company asked you a moment ago if you told Mr. Bulls when you handed him this $20,000.00 check to apply that on the Section 2 well, and you stated that you did not. At the time you handed Mr. Bulls that check, did you know of any other indebtedness which Tri-State Petroleum owed Baker & Taylor Drilling Company? A. No.

MR. BERRY: We object to that as immaterial, Your Honor.

THE SPECIAL MASTER: Overruled.

Q. BY MR. UTLEY: Did Mr. Bulls at that time advise you of any other indebtedness owed by Tri-State to Baker & Taylor? A. No.

Q. Did Mr. Bulls at any time advise you that a portion of the three $20,000.00 checks had been applied on some pre-existing indebtedness? A. No.

Q. When did you first learn that it had been applied on some preexisting indebtedness? A. Well, it was some months later, or some weeks later, probably along in May or some time about that time.

Q. You mean the following year? A. Yes, 1963." (TR March 24-25, 1964 hearing, pp. 72-73)

At the July 1 and 2, 1964, hearing, J. D. Amend testified as to his conversation with Bulls, as follows:

"Q. Mr. Amend, was there an occasion when you took a $20,000.00 check made by Tri-State to the office of Baker & Taylor Drilling Company? A. Yes.

Q. To whom did you take that check? A. I believe I gave that check to Roy Bulls.

Q. And at that time was Mr. Bulls in his office or your office? A. He was in his office.

Q. Was there anyone else present at that time? A. No, I think not.

Q. And was that in December of 1962? A. Yes.

Q. Did you have a conversation with Mr. Bulls at that time? A. Yes, I did.

Q. What did you say to Mr. Bulls and what did Mr. Bulls say to you? A. I told Roy that I wanted to know if he received the money to the extent of $60,000.00, that Tri-State was supposed to pay that, or somebody was, Mr. Schlittler, and that if they didn't I wanted to know about it, that I had some other people that I thought would take the interest; and he told me that he would notify me if he received that amount, and he did.

Q. And what did he say in the subsequent conversation when he informed you of that? A. Well, we had discussed receiving these checks on several occasions, and he always told me when he received that check—

* * * * *

"Q. BY MR. LANDENBERGER: Confirming your answer first, Mr. Amend, to the occasion on which you took the $20,000.00 Tri-State check to the Baker & Taylor offices, was there any further conversation on that occasion, either by you or by Mr. Bulls? A. I don't believe there was, not of any consequence anyway.

Q. Was there any subsequent conversation, in person or by telephone, between you and Mr. Bulls pertaining to any Tri-State checks in relation to the Section 2 contract? A. Yes, there was. There was—

Q. When was the next occasion? A. Oh, it was possibly another week or ten days later.

Q. And did you and Mr. Bulls have any conversation on that occasion? A. Yes, we did.

Q. Was it in person or by telephone? A. As I recall, it was by telephone.

Q. And did you receive that call or make that call? A. I received the call.

Q. Did the person on the other end of the call inform you he was Mr. Bulls? A. Yes, he did.

Q. Are you familiar with Mr. Bulls' telephone voice. A. Yes.

Q. Had you talked with him on the telephone on numerous occasions? A. Yes.

Q. And what did Mr. Bulls say to you and what did you say to Mr. Bulls on that occasion, in that conversation? A. He said he had received the last of the checks, the full amount of the $60,000.00, or another $20,000.00 check. I don't recall just how it was put, but anyway it added up to his having received the $60,000.00.

Q. Was there anything else said by Mr. Bulls on that occasion? A. No.

Q. Anything else said by you to him? A. Not that I recall." (TR July 1-2, 1964, hearing, pp. 92-95)

"Q. Mr. Amend, you are familiar with the deposition Exhibit 12, are you not, the receipt for the $20,000.00 check 00142? A. Yes, I have seen that.

Q. That is the receipt that you received when you delivered the $20,000.00 check, is it not? A. I received this receipt some time after that. I don't know whether it was at that particular time or whether I received it in the mail. But I did receive a copy of this. I did receive it.

MR. UTLEY: May I see that receipt, Mr. Berry?

MR. BERRY: Yes.

Q. That actually marks the time, does it not, that you delivered the $20,000.00 check referred to there? A. Well, now, I don't know, Hy, whether it does or not. It would certainly be the approximate time. It would be close to it." (TR July 1-2, 1964 hearing, pp. 99-100)

"Q. BY MR. BERRY: At the time your deposition was taken, Mr. Amend, it was your best recollection that this receipt represented the time at which you delivered the check. Would that be your best recollection? A. Well, it would be the approximate time. It would be fairly close to it, within a day or two of it.

Q. Well, would you make any better guess about the time on it than that? A. Well I would guess that the thing, if it was mailed to me, was probably prepared right after I was there and mailed out, if I had to guess." (TR July 1-2, 1964 hearing, pp. 101-102)

"Q. Now, the conversations with respect to the $20,000.00 checks, telephone conversations with respect to the $20,000.00 checks, how many were there? A. I imagine one or two.

Q. Well, was it one or was it two? A. Well, now, I just don't remember. That has been quite a long time back, and Roy and I talked personally a lot and I wouldn't remember for sure whether it was personally we talked or how many times or whether it was by telephone every time.

Q. All right, you say you had a telephone conversation with Roy Bulls at the time you delivered this check 142.

MR. UTLEY: No, he didn't say that.

THE WITNESS: No, I didn't say I had that. I said I delivered that check. I believe I delivered it to Roy. However, I might not have, but that is my recollection, that I did deliver it to Roy.

Q. BY MR. BERRY: It is just as possible you delivered it to Max? A. It could be that I did.

Q. Now, did you have a conversation with Roy at the time you delivered this check 142? A. Well, of course—

THE SPECIAL MASTER: Is that the check that was earmarked for Section 2?

MR. BERRY: Yes, sir.

THE WITNESS: Of course, I have testified from the beginning that I didn't know definitely the number on that check, or whether it had Section 2 on it, that I thought it did and that that was probably the check, and I did have a telephone conversation with Ray when that check was delivered.

Q. BY MR. BERRY: A telephone conversation or a personal conversation? A. I mean a personal conversation.

Q. The only check that identified Section 2, when it was delivered you had a telephone conversation? A. At about that time, I did, yes.

Q. And that was a personal conversation? A. Well, I believe that it was.

Q. All right. Now, did you have one or more other personal telephone conversations with Roy about — at least one or more others? A. At least one more, yes.

Q. One more, and would it be your present recollection that it was one more? A. No, it wouldn't. I wouldn't attempt to say because we had numerous conversations, telephone conversations, and whether we mentioned a $20,000.00 check or not I wouldn't attempt to say." (TR July 1-2, 1964 hearing, pp. 103-105)

"Q. Mr. Amend, were there ever any discussions between you and Roy Bulls about how the checks that had been delivered by you in connection with the Nusbaum well were to be applied? A. No.

Q. Were there ever any discussions between you and Mr. Bulls about how the checks which Baker & Taylor received from Tri-State should be applied? A. No.

Q. Were there ever any discussions between you and anybody else connected with Baker & Taylor Drilling Company about how the checks delivered by you to Baker & Taylor in connection with the Nusbaum well should be applied? A. No.

Q. Were there ever any discussions between you and anybody connected with Baker & Taylor Drilling Company about how the checks received by Baker & Taylor from Tri-State should be applied? No." (TR July 1-2, 1964, hearing, p. 108)

By the deposition of J. D. Amend which was introduced in evidence at the March 24 and 25, 1964, hearing, as Exhibit 1, Amend's testimony was as follows:

"Q. Now did you handle the credits on the Wilbanks well? A. Did I handle what?

Q. The payments on the Wilbanks well to Baker & Taylor Drilling Company? A. I presume you have reference to those three $20,000.00 checks?

Q. Whatever was paid. Now we may as well move into the three checks that were referred to here. A. Well, one of those checks was sent directly to me and the other two checks were sent direct, as I remember it.

Q. You don't have the originals of those $20,000.00 checks? A. No.

Mr. Utley: I have the originals.

Q. The contract for the drilling of the Wilbanks well on Section 2, as set out here in Defendant's Exhibit One, made between you and Baker & Taylor Drilling Company; now, you say of the $20,000.00 checks, you delivered one check after it was sent to you?

Which check was that? If you know? A. I don't know. I couldn't tell you. I think that it was possibly the second check but I just don't know.

Q. I am handing you check Number 142 and a receipt on December, 1962, and ask you to look at those A. This looks like the same.

Mr. Berry: Identify those as Deposition Exhibits 12 and 13, I believe.

Q The one check that you delivered and was receipted for was the only check of Tri-State that you had anything to do with then, Mr. Amend, with respect to the Wilbanks well? A. Well, that is the only one that I received, if that is the one, and I believe that it is.

Q. Your receipts for Check Number 142— A. Yes, it corresponds with that check, all right.

Q. If there were two other checks of $20,000.00, received by Baker & Taylor Drilling Company from Tri-State, at any time; you didn't have anything to do with those? A. Do you mean actually receiving and delivering the checks?

Q. Well, we'll say first, did you have anything to do with the delivering or receiving of any other checks, whatsoever, from Tri-State in connection with the Wilbanks well than the one that you were receipted for? A. No.

Q. Did you have anything to do with them in any fashion? with those checks? A. Well, I don't know whether I know what you mean by—

Q. Anything that you have to do with them, any dealings that you had or any correspondence pertaining to them. A. Any dealings that I had with those, of course, it was my understanding—is this what you want, now—my understanding of what the checks represented?

Q. No. No, I just want to know of any conversations, communications, or correspondence, or directions. A. I was notified that the checks had been received.

Q. You mean of Baker & Taylor Drilling Company? A. Yes. Roy Bull notified me.

Q. Now did you have any instruction from Tri-State Petroleum with respect to those checks? Did they communicate with you about them? A. Well, they told

me that they had sent the checks but they didn't give me any instructions about the checks. They just told me they had sent the checks to Baker & Taylor.

Q. Now, did you know at the time those two $20,000.00 checks of Tri-State were received by Baker & Taylor Drilling Company, that there was yet a substantial indebtedness owing in connection with the Nusbaum well? A. I was aware only of the small indebtedness, if one even existed. I had presumed and this is only a presumption, that Baker & Taylor had received $60.000.00; $30,000.00 that I had given to them and $30,000.00 in escrow or in some other way.

But that was only a presumption. I didn't know that they hadn't. I do now." (Exhibit 1 - Deposition J. D. Amend, p. 27-29)

"Q. Now, three checks that you knew or heard something about, are those, as you understand it, copies of those three checks? A. As I understand it, they are.

Q. And one of those is Check Number 1027? A. One of them is what?

Q. Check Number 00127? A. That is right.

Q. Check Number 10042. A. That is 00142.

Q. And Check Number 00156? A. That is right.

Mr. Utley: Those are for $20,000.00 each.

Mr. Berry: Yes.

Q. Now the copies that you have, don't show a stub on Check Number 1042, which refers to Section 2, does it? A. No, it doesn't.

Q. Mr. Amend, with respect to the Wilbanks well, according to your computation, what would yet be owing Baker & Taylor Drilling Company, on account of the drilling of that well? A. On which well?

Q. The Wilbanks well, on Section 2? A. I wouldn't know. It would just depend on how those three $20,000.00 checks were credited. If they were credited as I presume they would be, there wouldn't be anything

due. In fact, I might have a credit with Baker & Taylor.

But as to how they were credited and so forth, I don't know.

Q. You don't know how they were credited and you don't know how they were supposed to be credited? A. That is right. I can just only tell you what I understood.

Q. And you gave no direction with respect to the crediting of them? A. No." (Exhibit 1 - Deposition of J. D. Amend, pp. 30-32)

"Q. * * * When did you first have an understanding with Mr. Schlitter pertaining to any interest he or his companies with which he was connected would have an interest in the well on Section 52, Wilbanks? A. Section 2?

Q. Section 2, yes, sir. A. Well, that would be more or less of a carry over because for this reason, they had gone along on these other wells and had drilled the previous wells, but when I secured that farm-out on Section 2, I told Schlittler we would have to have the money to drill this thing with.

That some of those bills were slow and hadn't been paid and so forth and people were getting hot checks.

And that started about the time that I got the agreement with Phillips on this Section 2.

It was understood that if Schlittler and Johnson and the Fish Estate came up with the $60,000 which they had been paying for three-fourths interest, that they could participate in Section 2.

Q. And it was subsequent to that that you wrote this letter so stating that they could have an interest in it upon the payment of the expenses? A. Well, when this letter was written, I had presumed that the drilling cost had been paid.

Q. From what circumstances had you presumed the drilling cost had been paid?

What were the circumstances that caused you to believe that? A. Well, it was probably more of a lack of knowing about it than knowing about it. I had delivered this one check and then I had asked Roy Bulls to let me know if this money came in because I wanted to sell this interest to someone else.

Q. You were talking about Section 2? A. Section 2.

Q. You say Roy who? A. Roy Bulls.

Q. Who is he? A. He is connected with Baker and Taylor Drilling Company.

Q. Do you know in what capacity? A. I believe he is probably a vice president.

Q. And you told him to let you know? A. Yes.

Q. What? A. Let me know if he received that $60,000 for that well.

Q. Did you later talk to him about it? A. Yes, he called me and told me that he had received the $60,000 when he got the last check.

Q. That was in December of '62? A. Right. Let me correct something there.

Q. And—all right. A. I said for that well, the well itself, was actually, never discussed. It was just presumption on my part that the $60,000 was for this well.

And Roy told me that he had received $60,000.

Q. Did you know about any other indebtedness that might be due from Tri-State to Baker & Taylor? A. No, I didn't.

Q. And it was the expense on Section 2, that is, the $60,000 on Section 2 that you asked him to inform you about when he received the money? A. That is right.

Q. And subsequent to that he called you and said he received the $60,000? A. Yes.

Q. But when you first asked him to keep you informed or to inform you when he got the money, you specifically talked about Section 2? A. That is right.

Q. Had Baker and Taylor ever told you or anyone connected with them ever told you that there was a balance due on Section '64? A. Section 54?

Q. Section 54. A. Well, Max Banks told me about that not too long after that that there was a—

Q. I know but that was after your conversation with the other gentleman about receiving the $60,000, wasn't it? A. That is right. If they did tell me, it sure didn't register with me, because I wasn't aware of it.

Q. And you have some photostats of those three $20,000 checks you refer to? A. Yes, sir.

Q. Now, the checks that you refer to as Baker & Taylor having received, the first in point of date is December 15, 1962, in the sum of $20,000, payable to Baker & Taylor, drawn on the Greenfield State Bank, Bakersfield, California, and signed by Schlittler and Mr. Buntin? A. Yes, these are the checks.

Q. And the other two are both dated—let me see the dates there.

The next in point of date is December 17, 1962, in the sum of $20,000 payable to Baker & Taylor Drilling Company Box, Post Office Box 2748, Amarillo, Texas, signed by Mr. Schlittler and Mr. Buntin drawn on the Greenfield State Bank, Bakersfield.

And the third one was in the same sum on the same bank signed by the same persons, payable to Baker & Taylor, dated December 20, 1962, in the sum of $20,000? A. That is right.

Q. And those are the three checks that you were informed had been received? A. Right.

Q. And you were informed by Baker & Taylor that they had been received? A. Yes.

Q. Now, those checks were received in the month of December, were they not? A. Well, from the dates, I presume that they were." (Exhibit 1—Deposition of J. D. Amend, pp. 63-68)

"Q. Well, anyway, the checks that was coming through for payment at that time were all Tri-State Petroleum, were they not? A. Yes.

Q. Which indicated it was a Tri-State Petroleum interest? A. Well, the checks were all Tri-State checks, and where their money came from, I wouldn't know, but they all were Tri-State checks.

Q. Now, this agreement between you and Mr. Banks of Baker & Taylor, was between you and Baker & Taylor Drilling Company.

Now, when these checks of Tri-State Petroleum began coming through and were delivered to Mr. Banks' company, was there anything said about Schlittler's interest in that to Mr. Banks or to anyone in connection? A. Yes, I talked to Mr. Bull to this extent about it. I told him that I wanted to know if that was paid because if it wasn't paid, I wanted to sell that interest to somebody else.

Q. And he told you he would let you know? A. Yes, he did.

Q. Was it subsequent to that that he did call you and say that he had received the $60,000? A. That is right, received $60,000.

Q. All right." (Exhibit 1—Deposition of J. D. Amend, p. 76)

"Q. Now, J. D., you didn't, on June 13, when you wrote the letter to Schlittler, Exhibit 25, know anything about what the credits were supposed to be on the Nusbaum or the Wilbanks wells, did you? A. I didn't know about what they were supposed to be?

Q. Right. A. No.

Q. And you don't now know what they were supposed to be, do you? A. No, I don't." (Exhibit 1—Deposition of J. D. Amend, pp. 85-86)

"Q. And you never at any time and don't now take the position that anything was paid in connection with

the two wells over and above and in excess of $100,000, do you? A. That is all I would know about.

Q. And you don't know now how that $100,000 should have been applied as between the Nusbaum and the Wilbanks wells, do you? A. No.

Q. And you don't take any position about that yourself at this time? A. No, I don't.

Q. Now, when was the conversation with Roy Bulls that you mentioned a while ago about Baker & Taylor having received $20,000, three $20,000 checks? A. Well, I don't know whether I made myself clear or not.

I told Roy that I wanted to, if this money didn't come up, that I wanted to sell that interest elsewhere, and I wanted him to let me know.

Mr. Utley: You say that interest; what interest? A. The three-quarters working interest in the Number 2 well.

I wanted him to let me know if and when he received $60,000.

And Roy let me know, and I was of the opinion that it was immediately after the last checks came.

Q. Did he tell you that the $60,000 was to be credited to the Wilbanks well? A. No, there wasn't any mention of credit at all.

Q. Tri-State had been responsible to Baker & Taylor for the drilling of the Nusbaum well so far as the drilling is concerned? A. Yes.

Q. And you were responsible to Baker & Taylor Drilling Company for the contract price for the drilling of the Wilbanks well? A. That is right.

Q. And did anybody ever tell you that anything more than the $100,000 had been received by Baker & Taylor Drilling Company in connection with the 2? A. No." (Exhibit 1, Deposition of J. D. Amend, pp. 87-88)

"Q. So what would your recollection be that your conversation with Roy Bulls was with respect to re-

ceipt of the $20,000—of three $20,000 checks, was before the completion of the Wilbanks well or would it have been after the completion of the Wilbanks well? A. It was before the completion of that.

Q. It was before the completion of the Wilbanks well? A. Right.

Q. And that conversation was at the time then that the amounts payable were under your contract with Baker & Taylor were not yet payable, wasn't it? A. That is right." (Exhibit 1, Deposition of J. D. Amend, p. 89)

APPENDIX EXHIBIT 11.

Testimony of Roy Bulls as to Conversation With J. D. Amend.

At the July 1 and 2, 1964, hearing, Roy Bulls testified as follows:

"Q. Now, Mr. Bulls, were there any conversations between you and Mr. Amend about any $20,000.00 checks or any checks to be received or received from Tri-State Petroleum, Inc? A. Yes.

Q. What was those conversations? A. The monies—

* * * * *

Q. BY MR. BERRY: Mr. Bulls, can you fix by day or date the time of those conversations? A. No, I don't remember any specific date.

THE SPECIAL MASTER: Approximately.

Q. BY MR. BERRY: Were the conversations before the time of the completion of the Wilbanks well? A. Yes.

Q. And do you know where those conversations were? A. In J. D.'s office I would say.

Q. What were the conversations between you and J. D. Amend about checks received or to be received from Tri-State Petroleum?

MR. LANDENBERGER: May we have who was present, counsel, please, on that occasion?

Q. BY MR. BERRY: I will ask you who was present at those conversations. Was there anybody present at those conversations? A. As I remember, there wasn't.

MR. UTLEY: There were you and Mr. Amend. Is that all?

THE WITNESS: Mr. Amend and myself.

Q. BY MR. BERRY: What were the conversations? A. Oh, generally, we didn't know where the checks were—how the mode of payment would be, from

experience, and it was agreed between J. D. and I that he should—that should he get any monies in payment of the drilling he would let me know, and if any should come to us I would let him know.

Q. Did that refer to the Nusbaum well, those conversations? A. Yes.

MR. UTLEY: Wait a minute. You said it referred to the Nusbaum well or the Wilbanks well?

THE WITNESS: All three wells. This was over a period of time.

* * * * *

Q. What were the conversations? Were the conversations any more extensive than you have stated? A. No, never very extensive. There were several of them, usually very short in nature, usually in connection with or at the same time of one of the progress reports.

Q. Did you go at any time to Mr. Amend's office to talk to him about getting money specifically on the Nusbaum well? A. Yes. I made one trip down to his office for that reason.

Q. Was that before the commencement of the Wilbanks well? A. Yes, sir.

Q. Was there ever any—why did you go to Mr. Amend for money owing by Tri-State with respect to the Nusbaum well? A. Mr. Amend was the only man we ever had any dealings with.

Q. With respect to either of the three wells? A. Yes

Q. Did you ever have any direct dealings with Tri-State? A. Well, I met Mr. Schlittler on one occasion.

Q. Well, now, do you know when that was? A. No I don't.

Q. Did you have any business transactions with Mr. Schlittler? A. No, sir.

* * * * *

THE SPECIAL MASTER: Read the question again now, Mr. Reporter.

(Record read as follows:

'The conversations which you had with Mr. Amend with respect to money received or to be received from Tri-State, was there ever any discussion of any nature with respect to the application of any monies that you received?')

THE SPECIAL MASTER: Now, that is answerable by a simple yes or no.

THE WITNESS: No.

Q. BY MR. BERRY: Was there or not any reference to the Wilbanks well in conversations or conversation between you and Mr. Amend with respect to money to be received or received from Tri-State Petroleum? A. None that I recall.

Q. Did you report to Mr. Amend at any time that any check had been received by Baker & Taylor from Tri-State? A. Yes, I think so.

Q. At the time you reported such receipt, did you have conversations with Mr. Amend other than to report the receipt?

MR. UTLEY: Just a moment. I object to the form of the question. Let him state what was said.

Q. BY MR. BERRY: All right, what was said between you and Mr. Amend at the time you reported receipt of a check or checks from Tri-State?

MR. LANDENBERGER: Could we have where it took place?

THE SPECIAL MASTER: Time and place and parties present, the usual foundation.

MR. BERRY: All right.

Q. Was it by telephone or in person? A. By telephone.

Q. Was it more than one time, or do you know? A. I think on two occasions checks were received in our of-

fice and I called J. D. and told him the checks had been received.

Q. What time was it, if you know? A. I don't remember. I couldn't put a date on it.

Q. Would it have been before or after the completion of the Wilbanks well, or do you know? A. I would say before the completion.

THE SPECIAL MASTER: Was anyone else present? A. The conversations were had by telephone, if I remember correctly. I imagine that Mr. Banks or someone else was in the office at the time the calls were made.

THE SPECIAL MASTER: State the conversation as nearly as possible in 'I said' and 'He said' form.

MR. BERRY: Do the best you can.

THE WITNESS: I called J. D. on the phone and told him that we had received a $20,000.00 check.

Q. BY MR. BERRY: What did he say? A. He acknowledged it, as well as I remember.

Q. Was anything more said by your or by him? A. Not that I remember.

MR. BERRY: Pass the witness.

Cross Examination

BY MR. LANDENBERGER:

Q. Referring now, Mr. Bulls, to the conversation you have just related on the telephone, didn't you tell Mr. Amend whose check it was? A. I probably stated it was from Tri-State.

Q. And you said nothing more than that you had received it? A. That is right, as our agreement.

Q. Parden me? A. As per our agreement, mine and J. D's agreement.

Q. Your agreement about what? A. In a previous conversation J. D. and I had agreed that if either of us received money on the payment of the wells we would notify each other.

Q. So you were merely notifying him that you had received a $20,000.00 check from Tri-State? A. That is right.

Q. Was there any conversation as to where that payment would be applied? A. No.

Q. Where was it applied?

MR. BERRY: If you know, say so and if you don't know say so.

THE WITNESS: I don't know.

Q. BY MR. LANDENBERGER: Do you know whether or not the check you are now referring to was a check that had some designation of Section 2 on it? A. No, I don't think so.

Q. Did you ever have a conversation with Mr. Amend about a check from Tri-State that did have such a designation on it? A. No, I don't remember that I did.

Q. Was there any other occasion when you had a conversation with Mr. Amend about a check from Tri-State? A. I remember I think calling him on a second check that we received in the mail.

Q. What did you tell him on that occasion? A. That we had received a check for $20,000.00.

Q. Did you tell him it was from Tri-State? A. I can't swear that I did, no.

Q. And did you personally receive either or both of the checks you have just referred to from the mail, Mr. Bulls? A. No, sir. I don't open the mail.

Q. Were they handed to you by someone else in the organization? A. No, sir, Mr. Bowie merely told me that the checks were in.

Q. In other words, you didn't have the checks before you when you were speaking with Mr. Amend? A. Probably not.

Q. Did you give any directions to Mr. Bowie as to how the checks should be applied? A. No, sir.

Q. Do you know of any other officer or director of Baker & Taylor Drilling Company that gave him any

directions as to how the payment should be applied? A. Probably so, in some discussions between the officers at one time or another. I don't know definitely, no.

Q. Were you present in court yesterday when Mr. Bowie testified? A. Yes, sir.

Were you present when he testified that he considered Mr. Amend and Tri-State to be interchangeable accounts? A. What was your question?

THE SPECIAL MASTER: Read the question.

MR. BERRY: I don't believe that was the testimony.

THE SPECIAL MASTER: Well, it comes pretty close to it. The objection, if this be an objection, is overruled.

Read the question, Mr. Reporter.

(Record read.)

THE WITNESS: Yes.

Q. BY MR. LANDENBERGER: Did you consider them to be interchangeable accounts? A. Well, I always looked to Mr. Amend for the whole business. He was the only man I ever had any dealings with.

Q. Well, would you have considered a check from Tri-State to be a payment on Mr. Amend's account?

MR. BERRY: If it please the court, that calls for a conclusion of the witness—

THE SPECIAL MASTER: This is cross examination. The witness may answer. Read the question.

(Record read.)

THE WITNESS: I think yes.

Q. BY MR. LANDENBERGER: If you had received a check from Mr. Amend at a time when an account was owing from Tri-State, would you have applied it on Tri-State's account? A. Yes.

Q. Mr. Bulls, did you ever have a conversation with Mr. Amend in which you told him that the entire $60,000.00 had been received from the drilling on Section 2? A. No. sir.

Q. Did you ever have a conversation with him in which you told him that any amount of money had been received and paid on the drilling of Section 2? A. No, sir. I never did specify any particular well on any of the payments.

Q. Then as far as any conversation that ever took place between you and Mr. Amend, you never informed him that any money had been paid on the Section 2 drilling contract, did you? A. I don't think so.

Q. Were you present when Mr. Bowie testified concerning an office practice of not sending invoices to customers except the original invoice for the contract price—an office practice of your company, that is? A. Yes.

Q. Was that or is that the practice of the company? A. Yes.

Q. Did you ever have a conversation with Mr. Amend in which you informed him that there was a balance due on the Section 2 drilling job? A. No.

Q. Was there ever an occasion when Mr. Amend personally handed you a Tri-State check in the amount of $20,000.00? A. No.

Q. Or in any other amount? A. I think that J. D. handed me two checks, I thought they were $5,000.00 each, at one time." (TR July 1 and 2, 1964, hearing, pp. 72-83)

"Q. Didn't Mr. Amend tell you when he was talking to you about the Section 2 well that he wanted to know whether or not Tri-State sent this money? A. I didn't think that he was specifically talking about Section 2.

Q. Well, he had such a conversation with you, didn't he? A. We talked about receiving money from Tri-State, in one or two conversations.

Q. Do you recall his having told you that he was liable for the payment of the drilling of No. 2 and if

Tri-State didn't send the money he wanted to know it? Didn't he make that statement to you? A. I don't remember that statement.

Q. You wouldn't say he didn't make it, would you? A. I don't remember him making that statement.

Q. Now, you did call him up when two separate checks came in for $20,000.00 each, didn't you? A. Yes.

Q. And you knew that one $20,000.00 check had been delivered to the office didn't you, by Mr. Amend? A. Yes.

Q. And didn't you tell him when you got the last $20,000.00 check through the mail that you had received the $60,000.00, three checks for $20,000.00 each? A. I never mentioned the total figure.

Q. But you knew there were three $20,000.00 checks that came in about that time, didn't you? A. I remember three $20,000.00 checks being involved, yes.

Q. And you mentioned that to Mr. Amend, didn't you? A. I don't remember mentioning that to him. I merely remember making the two separate calls telling him that a $20,000.00 check had been received each time.

Q. And didn't you tell him that you had received the full $60,000.00? A. No, sir.

Q. Well, you had received the $60,000.00 at that time, hadn't you? A. I guess we had.

Q. And your understanding with Mr. Amend was that if he got in checks he would let you know and if you got in checks you would let him know, is that right? A. Yes, that was my understanding.

MR. UTLEY: That is all." [TR July 1 and 2, 1964, hearing, pp. 88-89)

APPENDIX EXHIBIT 12.

December 19, 1962

RECEIVED of J. D. Amend this 19th day of December, 1962, Tri-State Petroleum, Inc. check No. 00142 in the amount of Twenty Thousand Dollars ($20,000) to be applied on account.

Max E. Banks,
Max E. Banks, President

Index to Exhibits
Which Are Part of Record.

BAKER & TAYLOR DRILLING CO. EXHIBITS:

TRUSTEE'S EXHIBITS:

ANDERSON'S EXHIBITS:

No. 20071

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BAKER & TAYLOR DRILLING CO.,

Appellant,

vs.

R. W. STAFFORD, Trustee,

Appellee.

APPELLEE'S BRIEF.

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TABLE OF AUTHORITIES CITED

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APPELLEE'S BRIEF.

PRELIMINARY STATEMENT.

The Statement of Facts set forth in the brief filed by Baker & Taylor Drilling Co. (for the sake of brevity hereinafter sometimes referred to as "Baker & Taylor"), contain certain alleged facts not found by the Court to be true, and not pertinent to the issues involved herein, while certain other important and material facts are not mentioned. Certain other mentioned facts are not entirely correct and are misleading.

In our Statement of Facts, and in our reference to the pleadings, which established jurisdiction, we shall endeavor to mention those facts which are important and material in the determination of the main issues involved in this appeal.

STATEMENT OF PLEADINGS AND FACTS SHOWING JURISDICTION IN THE BANKRUPTCY COURT.

For the convenience of the Court, and to make crystal clear what the Trustee is attempting to accomplish by this litigation, and to establish jurisdiction, we shall set forth in our Appendix No. 1 of this brief, the Trustee's Application for the relief sought therein; and as Appendix No. 2, a copy of the Order to Show Cause on which the issues herein were presented.

The within bankruptcy proceeding was originally commenced by Tri-State Petroleum Inc., in filing a petition under the provisions of Section 128 of Chapter X of the Bankruptcy Act on the 17th day of June, 1963, in the United States District Court for the District of Nevada. The petition was approved by the Court on June 24, 1963, and the Court on the last mentioned date appointed R. W. Stafford as Trustee, and said Trustee duly qualified and has at all times since continued to act as Trustee of said Estate. The Order of the Court of June 24, 1963, contained the usual provisons restraining all persons from interfering by lawsuit or otherwise with the Trustee and the debtor's property, wherever located. [See Par. XV, p. 17 of Tr. of R. re Order June 24.]

This debtor proceeding was subsequently, on motion of creditors, transferred to the United States District Court for the Southern District of California, Central Division, and this Honorable Court signed an Order on or about September 4, 1963, referring said proceeding to Ronald Walker, a Referee in Bankruptcy, and to said Referee as Special Master, to hear and report generally upon such matters as may require the judgment of the

Judge of this Honorable Court, pursuant to the provisions of Section 117 of Chapter X of the Bankruptcy Act. (We do not find in the record before this Honorable Court the Order of the District Judge dated September 4, 1963, but we shall ask the Court to augment the record by having said Order certified to the Court, unless Counsel for Appellant agrees that the Order referred to was so made.)

During the course of the administration of said estate, the Trustee found that among the properties in which the debtor corporation had an interest were certain oil and gas wells and leases, located in the County of Hansford, State of Texas, among which is a gas well located on the Southeast Quarter of Section 2, Block 1, H&GN Ry. Co. Survey, County of Hansford, State of Texas. This particular gas well is located approximately 7½ miles southeast of the City of Spearman, Texas. [R. Tr. March 24, 1964, p. 9, line 15.] Also, [R. Tr. March 24, 1964, p. 34, line 26.]

The debtor corporation became interested in these properties in the following manner:

Some time prior to May of 1962, and probably in the latter part of 1961, the predecessor of the debtor corporation, to wit, Midwest Petroleum Corporation, became interested with J. D. Amend of Amarillo, Texas, in the drilling of certain oil and gas wells in the County of Hansford, State of Texas, upon certain properties upon which J. D. Amend held leases for the drilling of oil and gas wells. [R. Tr. March 24, 1964, p. 35, line 16.] Briefly, the agreement between J. D. Amend and the debtor corporation was to the effect that if the debtor corporation would furnish the drilling costs for the drilling of these wells, which amounted to the ap-

proximate sum of $60,000.00 each, and would subsequently pay three-fourths of the costs and expenses necessary to place said wells upon production, J. D. Amend would then assign to the debtor corporation or its nominees a three-fourths interest in said oil and gas wells and leases. (See Amend letter in Appendix No. 1.)

The first of the properties drilled upon was known as "Section 56," in the County of Hansford, State of Texas, lying approximately 2 or 2½ miles southeast of the City of Spearman. [R. Tr. March 24, 1956, p. 35.]

Pursuant to the arrangement between J. D. Amend and the debtor corporation, and on or about May 24, 1962, Baker & Taylor Drilling Company of Amarillo, Texas, entered into a contract with J. D. Amend of Amarillo, Texas, for the drilling of a well for oil, gas and other petroleum products to an agreed depth on said Section 56. This drilling contract provided for a lump sum payment of $58,000.00 to be paid for the drilling of the well to the agreed depth, together with any other sums which might accrue for certain additional work referred to as "day rate compensations," if any should arise. (See Contract in Evidence.)

This contract provided that the sum payable shall be paid within thirty (30) days after completion of the drilling of the well. Performance of this work was completed on or about June 18, 1962 and payment therefor was completed on or about July 12, 1962. The drilling cost of this well was paid and advanced by the debtor corporation, [R. Tr. March 24, 1964, p. 102, line 22] and it also advanced its three-fourths interest for the payment of the other costs, pursuant to its agreement with J. D. Amend [R. Tr. March 24, 1964, p. 10].

and since there was a productive oil well on said property, J. D. Amend assigned to the debtor and debtor's nominees a three-fourths interest in said oil well and lease. The performance and payment under this contract are not here involved, except insofar as it shows a relationship between Baker & Taylor, J. D. Amend and the debtor corporation. [R. Tr. March 24, 1964, p. 10, line 4, to p. 35, line 19.]

On or about August 24, 1962, and pursuant to the original agreement between J. D. Amend and the debtor corporation, the debtor corporation this time entered into a contract for the drilling of an oil and gas well with Baker & Taylor Drilling Co. upon Section 54, Block 4-T, T&NO Survey, Hansford County, Texas. [R. Tr. March 24, 1964, beginning p. 10, line 16.] This well was to be drilled to the depth of 8200 feet from the surface, or to 100 feet in the Mississippian formation, whichever is the lesser, unless stopped at a lesser depth at the request of Tri-State Petroleum, Inc. This contract provided for the payment to Baker & Taylor Drilling Co. by Tri-State Petroleum of a lump sum of $60,000.00 for the drilling of a well to the aforementioned depth, together with any sums which might accrue for additional extra work, referred to as day rate compensation. [See B & T Ex. D.] This contract provided for $30,000.00 of the sum to be paid for the drilling, to be placed in escrow and this amount to be due at the conclusion of the drilling of the well, and the remaining sum to be due thirty (30) days after completion of the drilling of the well. The contract did not specifically provide with whom the $30,000.00 should be placed in escrow. No escrow was ever established.

However, the debtor corporation mailed to J. D. Amend its check dated August 24, 1962, payable to Baker & Taylor Drilling Co. in the sum of $30,000.00. Drilling of the well was commenced on or about August 31, 1962 and on or about September 21. 1962, Baker & Taylor received from and receipted to J. D. Amend for this check for $30,000.00. This check was deposited to the account of Baker & Taylor Drilling Co. on or about September 21, 1962 and was returned unpaid by the drawee bank, but was again deposited by Baker & Taylor on or about October 10, 1962 and paid by the drawee bank. The debtor corporation also mailed to J. D. Amend its check No. 3438 for $5,000.00, made payable to J. D. Amend and dated October 29, 1962, and endorsed by J. D. Amend to Baker & Taylor Drilling Co. to be applied upon the account of Tri-State Petroleum, Inc. for the drilling of the well on Section 54. [R. Tr. March 24, 1964, p. 45, line 20.] The third check, No. 3418 dated October 22, 1962 for $5,000.00 from Tri-State Petroleum, Inc. was mailed to J. D. Amend and payable to J. D. Amend and endorsed by him to Baker & Taylor. There were extra charges for the drilling of this well, so that the total Baker & Taylor Drilling charged and other work performed was $70,036.63. [R. Tr. March 24, 1964, p. 42, line 6.] [See Finding No. V.] Insofar as the record shows, no other monies were mailed by the debtor corporation for the payment of the drilling costs on Section 54, and there remained a balance due from Tri-State Petroleum, Inc. to Baker & Taylor Drilling Co. as shown by said Finding No. V. The drilling of the well on Section 54 resulted in a "dry hole," and no further action was taken in connection therewith.

Drilling of the Well on Section 2.

We come now to the drilling of the well which is the principal subject matter of this litigation.

On or about December 1, 1962, Baker & Taylor entered into a drilling contract with J. D. Amend for the drilling of a well for oil, gas and other petroleum products on Section 2, Block 1, H&GN Ry. Co. Survey, County of Hansford, State of Texas. This well was to be drilled to a depth of 5400 feet from the surface, or to 100 feet in the Mississippian formation, whichever is the lesser, unless J. D. Amend requested that the drilling be stopped at a lesser depth. The contract provided for payment to Baker & Taylor by J. D. Amend for a lump sum of $58,000.00 for the drilling of a well to the above depth, together with any sum which might accrue for additional or extra work, referred to as day rate compensation. The contract provided that the sum shall be payable in thirty (30) days after completion of the drilling of the well. The drilling of this well was completed on or about December 22, 1962. This particular contract provided that included in the services to be performed for the $58,000.00, one drill stem test was to be run, but provided that if J. D. Amend should elect not to have the drill stem test run, he should be credited with $800.00. Mr. Amend elected not to have the drill stem test run, so that at the completion of the well, J. D. Amend was entitled to $800.00 credit on the $58,000.00 lump sum payment provided in the contract, and no question is presented as to the exact amount which was to be paid for the drilling of this well; and no question arises about Baker & Taylor properly performing the services to be performed in the drilling of said well. [R. Tr. March 24, 1964, p. 48, line 6.]

Pursuant to the agreement between J. D. Amend and the debtor corporation, that the debtor corporation was to advance the drilling costs for the drilling of the well on Section 2 above mentioned, the debtor corporation mailed to J. D. Amend its check dated December 15, 1962 in the sum of $20,000.00, payable to Baker & Taylor Drilling Co. and marked upon the stub attached to said check "On account, Section 2, $20,000.00." J. D. Amend immediately took this check to Roy Bulls, secretary of Baker & Taylor Drilling Co., and delivered it to him. At the time of said delivery of said check to Roy Bulls, J. D. Amend stated to Mr. Bulls that Tri-State Petroleum, Inc. had agreed to pay the drilling costs for this well on Section 2. Mr. Amend further stated to Mr. Bulls at the time that he did not want to carry a further interest in this well; that he could not afford to, and that if Tri-State Petroleum did not come up with this money, that he wanted to be informed about it, as he had some other people he thought would buy this interest; Roy Bulls then and there told J. D. Amend that he would notify him as to whether or not his company received further payment; that within a few days thereafter, Roy Bulls called J. D. Amend by telephone and told Mr. Amend that his company had received the third check from Tri-State Petroleum Inc. in the sum of 20,000.00, or a total of $60,000.00. While the check of December 15, 1962 was made payable to Baker & Taylor Drilling Co., it was delivered to them through J. D. Amend. The other two checks of $20,000.00 each were mailed directly to Baker & Taylor in December of 1962 and had no statement on the checks indicating the purpose for which they were delivered. These last two checks were dated December 17th and 20th, 1962 and were in the sum of 20,000.00 each.

Notwithstanding the fact that the contract called for the payment of these drilling costs to Baker & Taylor within thirty (30) days after the completion of the well (the well having been completed on December 22, 1962) yet it is observed that all three of these payments were made prior to the completion of the well. [See quoted evidence in this brief.]

Notwithstanding the conversation between J. D. Amend and Roy Bulls, and Mr. Bulls' telephone call back to Mr. Amend that the drilling costs on this well [Section 2] had been paid, Baker & Taylor Drilling Co. proceeded to apply all of the check dated December 17, 1962 to the balance due and payable by Tri-State Petroleum, Inc. for the drilling of the well on Section 54, and applied a portion of the check dated December 20, 1962 to the payment of the balance due by Tri-State Petroleum, Inc. for the drilling of the well on Section 54, and then applied the balance of said check to the credit of the J. D. Amend contract on Section 2. In other words, the check received by J. D. Amend and delivered to Baker & Taylor Drilling Co. was all applied on the Amend contract for the well on Section 2; all of the check dated December 17 was applied upon the balance due from Tri-State Petroleum for the drilling of the well on Section 54, and the check dated December 20, 1962 was first applied to the total balance due by Tri-State Petroleum for the drilling of the well on Section 54 and then the balance thereof was applied upon the payment of the J. D. Amend contract for the drilling of the well on Section 2.

The above application of funds is emphasized for the reason that Baker & Taylor Drilling Co., in the trial before the Referee, first insisted that it would not have

known that a check from Tri-State Petroleum, Inc. was to be applied upon the drilling of the well on Section 2, because the money was not yet due. [R. Tr. March 24, 1964, p. 49, line 26; R. Tr. March 24, 1964, p. 114, line 11.] Notwithstanding this contention, it is obvious that Baker & Taylor knew enough to apply the check dated December 15, 1962 to the cost of the drilling of the well on Section 2, which contract was signed by J. D. Amend, and it also apparently knew enough to apply the balance of the last check upon the J. D. Amend account. If Baker & Taylor Drilling Co. was as innocent as it contended, why would it be applying money of Tri-State Petroleum, Inc. to the payment of a J. D. Amend obligation without first securing authority so to do?

The facts in relation to the drilling of the wells on Sections 56 and 54 above mentioned were first developed by Baker & Taylor Drilling Co.

Filing of the Application and Order to Show Cause Re Validity of Lien Claims Against the Property Located on Section 2 Above Described.

After the Trustee had investigated the estate's interest in the gas well and the lease on Section 2 above described, and the fact that there were numerous liens filed against said property, on or about the 19th day of February, 1964 the Trustee filed an Application for an Order to Show Cause seeking to determine the validity of these liens, and seeking injunctive and other relief, and for a temporary restraining order. This Application, eliminating the title of the court and cause, is marked Appendix No. 1. The Order to Show Cause issued thereon by Ronald Walker, Referee in Bankruptcy

eliminating the title of court and cause, is marked herein as Appendix No. 2.

The pleading and Order [Appendices Nos. 1 and 2]. show the exact nature of the relief which the Trustee was and is seeking.

To this Application and Order to Show Cause, J. D. Amend, in whose name the title to the property stood and who was holding said property for himself and the debtor corporation, [25% interest in J. D. Amend and 75% interest in the debtor corporation] without objecting to the jurisdiction of the Bankruptcy Court, appeared *in personam* and filed the following Answer, which eliminating the title of Court and cause, is set forth as Appendix No. 3.

Subsequently, J. D. Amend filed a supplemental to his Answer which, eliminating the title of court and cause, is marked herein as Appendix No. 4.

Beacon Supply Company, one of the lien claimants, appeared without objecting to the summary jurisdiction of the Bankruptcy Court and filed its Answer, claiming a valid lien on said property. The Special Master held that this company had a valid lien as alleged.

Baker & Taylor Drilling Co. appeared especially for the purpose of objecting to the summary jurisdiction of the Bankruptcy Court and filed such objection, and also filed an Answer in which they set forth their claimed lien.

Halliburton Company and Welex likewise appeared and objected to the summary jurisdiction of the Bankruptcy Court, and filed an Answer, claiming certain liens which were allowed and approved by the Court.

The Referee, sitting as Special Master, reserved his ruling upon the question of summary jurisdiction until all of the evidence was presented, and then overruled the objection to the summary jurisdiction and made the Findings of Fact, Conclusions of Law and Order, which are herein questioned by Baker & Taylor.

The Principal Purpose of the Trustee's Application and the Order to Show Cause Issued by the Referee-Special Master Was to Seek a Determination of the Validity and Amount of the Liens Filed and Recorded of Record Against the Oil and Gas Lease and Gas Well on Section 2 Above Described.

It is very clear that the Trustee, in filing the application herein, was among other things seeking a determination of the validity and amount of the liens filed and recorded by the respondents upon the gas well and lease on Section 2, described in the application, which was property, although standing in the name of J. D. Amend, belonged to both J. D. Amend and Tri-State Petroleum, Inc., subject only to the payment of the valid liens against same.

J. D. Amend admits in both his answer and testimony that Tri-State Petroleum, Inc. had such an interest, and that J. D. Amend was able, ready and willing to transfer such an interest to the Trustee in Bankruptcy of Tri-State Petroleum, Inc., upon its payment of three-fourths of the valid lien claims, [R. Tr. March 24-25, 1964, p. 23, line 26, to p. 24, line 3] or was agreeable to sell the property and transfer to Tri-State Petroleum, Inc. or its Trustee its three-fourths interest after the valid lien claims were paid from the sales price.

It is clear that J. D. Amend was in actual possession of, and was holding this property for the benefit of Tri-State Petroleum, Inc. and himself as per their interests at the time of the filing of the bankruptcy proceedings herein.

Furthermore, Mr. Amend has voluntarily appeared in this proceeding and has submitted himself to the summary jurisdiction of the Bankruptcy Court and is seeking substantially the same relief as the Trustee herein.

None of the three respondents who objected to the summary jurisdiction of the Bankruptcy Court were ever in the possession of the property and at no time were any of them the owners thereof. They are nothing more than lien claimants against property admittedly owned jointly by the debtor and J. D. Amend. Of course, the only respondent now complaining is Baker & Taylor.

The Trustee has never questioned the fact that Baker & Taylor performed its work in accordance with its drilling contract entered into between itself and Tri-State Petroleum, Inc. on Section 54, and that Tri-State Petroleum, Inc. owed it a balance on the account in December, 1962.

Neither is there a dispute about the proper performance by Baker & Taylor in drilling the well on Section 2 under its drilling contract with J. D. Amend.

The dispute arises over the fact that it applied funds mailed to it for the payment of the drilling costs on Section 2, [R. Tr. March 24, 25, 1964, p. 164, line 7, to p. 165, line 12] to the balance due it by Tri-State Petroleum, Inc. for the drilling work on Section 54.

Even though the two checks of $20,000.00 each which it mailed directly to Baker & Taylor had no indica-

tion on the checks themselves that the funds were to be applied upon the drilling costs of Section 2, yet Roy Bulls, secretary of Baker & Taylor was informed by J. D. Amend that Tri-State had promised to send this money for this particular purpose and requested that he be informed when it arrived, and Mr. Bulls did inform Mr. Amend that it had been received. Mr. Amend was not informed of the fact that Baker & Taylor had applied any of these funds on the old account of Tri-State Petroleum, Inc. until the following May, 1963, a period of almost five months. (See Amend testimony bottom p. 5, Appellant's Appendix 10.)

Tri-State Petroleum, Inc. had agreed with J. D. Amend to pay the drilling costs to Baker & Taylor for its three-fourth interest in the lease and well, and the President of Tri-State Petroleum, Inc. testified that the three $20,000.00 checks were mailed for this purpose, and Mr. Bulls of Baker & Taylor was so informed by Mr. Amend, and was familiar with the working arrangement between Amend and Tri-State and accepted Tri-State as a proper person to pay the obligation of J. D. Amend. (See Cited Testimony of Both Amend and Bulls.)

Appellant in its brief under the heading "Argument" on Page 47, contends:

> "The Trustee, by his agents, claimed the debtor to be entitled to only 20½% of the well and lease involved. He listed 66% interest owed by others, including 25% by J. D. Amend."

This statement of counsel for Appellant is based upon a report filed by the Trustee on the 9th day of August, 1963, long before he knew the true facts of the case,

and which was not offered in evidence or called to the Special Master's attention at the time of the hearing herein, and not found by the Special Master to be true. [See Findings of the Special Master Numbers VIII and XIX, Conclusions of Law, and Order.]

It should be explained, however, that percents in this gas well were sold by the debtor, but the purchases of these percents elected to file claims in this Chapter X proceeding instead of demanding their percents under the rule of law announced by this Honorable Court in *Woods et al. v. Deck,* 112 F. 2d 739, and objections to said claims have been overruled by the Special Master and his report thereon to the District Judge recommending the allowance of the claims is pending as this is being written. This leaves the Trustee with the exact three-fourths interest, as set forth in Amend's letter of February 11, 1963, set forth in Appellant's brief as Appendix, Exhibit 7.

Should there be any question about the correctness of the record on this point at the time of argument, the Trustee will move to augment the record on appeal by producing proof of the above by a certification of this part of the Referee's record.

ARGUMENT.

Exclusive Jurisdiction of the Debtor and Its Property, Wherever Located.

Section 111 of Chapter X reads:

> "Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located."

In Volume 6, Collier on Bankruptcy, 14th Ed., at pages 571, 572 and 573, it is said:

> "Former §77B(a) contained a sentence couched in somewhat similar language, but it was rather vaguely worded so that there was some difference of opinion as to when jurisdiction attached. Present §111 is stated in such fashion as to remove any doubt that the jurisdiction conferred devolves upon the court at the time the petition for reorganization is filed.
>
> The broad grant of jurisdiction to the reorganization court by §111 is an essential element in the statutory scheme. Yet, as we shall see more clearly in subsequent discussions, it does not present any novel concept. The jurisdiction of the federal district courts sitting in bankruptcy is limited to matters conferred by statute or implied therefrom. In ordinary bankruptcy proceedings, once the petition is filed, the district courts as courts of bankruptcy are vested by Section 2 of the Act with exclusive and paramount jurisdiction—within the limits fixed by the Act—to administer the bankrupt's estate wherever located, *to determine all liens and claims*

pertaining thereto, and to prevent by proper orders the doing of anything that will at any stage of the proceedings, tend to embarrass or interfere with the court in the administration and distribution of that estate. The district court sitting in reorganization proceedings is a court of bankruptcy. Moreover, §§112 and 114 expressly give the court in reorganization proceedings the jurisdiction and powers of a bankruptcy court both before and after the approval of a reorganization petition.

Hence, in a general way §111 seems repetitious of existing power, but this is not wholly so. In order to insure that no break might be found in the statutory framework, an express grant of authority gives special emphasis to the reorganization court's special power. More important, the provision, occurring as it does, within the precincts of Chapter X, warrants a construction of the language in keeping with the context of the chapter. And accordingly a broader significance results, consonant with the wider scope of the reorganization proceeding. Thus we shall discover that the reorganization court may bring its authority to bear upon creditors in situations not possible in ordinary bankruptcy. And the words 'wherever located', construed in the light of the purposes of Chapter X, *permit the process of the reorganization court, in giving effect to its summary powers over the estate, to run outside the state where the court sits, a result not permissible in ordinary bankruptcy where ancillary proceedings are necessary to implement the court's jurisdiction in such cases. The essential purpose remains: to render the authority*

and control of the reorganization tribunal paramount and all-embracing to the extent required to achieve the ends contemplated by Chapter X; and to exclude any interference by the acts of others or by proceedings in other courts where such activities or proceedings tend to hinder the progress of reorganization.

It should be borne in mind, however, that §111 does not stand alone, and there is no necessity to stretch the words of the section to the utmost limits to attain the result desired. Such a course perhaps was compelled under §77B, where the jurisdictional provisions were not complete, and language in many of the older cases construing that section should be read in this light. Under Chapter X, on the other hand, in addition to the provisions of §§112 and 114, previously mentioned, §113 gives the courts broad power to grant temporary stays prior to approval of the petition; §115 authorizes the court to exercise all powers of an equity receivership court, once the petition is approved; and §116 confers upon the court, after the petition is approved, various express powers, including, in addition to the power to issue stays under §11 of the Act, the power to enjoin or stay until final decree the commencement or continuation of suits against the debtor or its trustee or any act or proceeding to enforce a lien upon the debtor's property. Section 148 provides that the approval of the petition in itself shall, until otherwise ordered by the judge, operate as a stay of prior pending bankruptcy, foreclosure or equity proceedings, and of any act or other proceeding to enforce a lien against the debtor's property. Sec-

tions 256 and 257 further insure that the court may compel the surrender of property held by a receiver or trustee in a prior pending mortgage foreclosure or equity proceeding, or held by a trustee under a trust deed, or a mortgagee under a mortgage. All of these express powers, then, make it unnecessary in many instances to rely on the general terms of §111, except, perhaps, to reinforce the specific grants. If this is remembered many difficulties of construction will be avoided." (Emphasis ours.)

Volume 6, Collier on Bankruptcy, 14th Ed., at page 574 quotes from Senate Report No. 1912, wherein it is said:

"Section 111, which is an amendment of Section 77B(a), gives to the court exclusive jurisdiction over the debtor and its property, wherever located, from the time of the filing of a petition under this chapter. More effective and orderly procedure is provided by thus eliminating the doubts which presently exist under Section 77B as to the nature and extent of the court's jurisdiction before the entry of an order approving a petition."

In holding that all property which the debtor has, *or may claim an interest,* passes under the control of the Bankruptcy Court, the Court in *In re Cuyahoga Finance Co.*, 136 F. 2d 18 at 20, says:

"The vital question on this appeal is whether the jurisdiction of the court ceases after restraining a pledgee creditor from disposing of the pledged assets in his possession without the consent of the court or whether such jurisdiction extends to de-

termine setoffs of the debtor without the consent of the creditor. It is settled law that upon the filing of a petition under Chapter X of the Bankruptcy Act, all property in which the debtor has, or may claim, an interest passes under the control of the Bankruptcy Court, and upon approval of the petition, title vests in the trustee or the debtor in possession as of the date of the filing of the petition. 11 U.S.C.A. §557, 52 Stat. 888; *Cross v. Irving Trust Company*, 289 U.S. 342, 344, 53 S.Ct. 605, 77 L.Ed. 1243, 90 A.L.R. 1215; *Isaacs v. Hobbs Tie and Timber Company*, 282 U.S. 734, 737, 51 S. Ct. 270, 75 L.Ed. 645. The jurisdiction of the court is not limited to the administration of the property which admittedly belongs to the debtor, but also extends to the determination of the question of title. *Ex Parte Baldwin*, 291 U.S. 610, 54 S.Ct. 551, 78 L.Ed. 1020. To this end the Bankruptcy Court may enjoin creditors collaterally secured from selling or disposing of such collateral without the consent of the court and may make all orders necessary to prevent hindrance or delay in the preparation and consummation of the plan of reorganization. *Continental Illinois Nat. Bank & Trust Co. v. Chicago, Rock Island & P. Railway*, 294 U. S. 648, 676, 55 S. Ct. 595, 79 L. Ed. 1110."

In a case decided prior to the enactment of Chapter X, and in passing upon the extended jurisdictional powers of the Bankruptcy Court under the provisions of Sections 77A and 77B, it is said:

"Our conclusions are that the jurisdiction of the bankruptcy court in proceedings under 77B has been extended by Sections 77A and 77B so that it

includes all of the property of the debtor, wherever located, even if such property is in the possession of a lienholder, and even if such possession has continued for more than four months prior to the initial petition of the debtor under Section 77B; and that the trial court had jurisdiction to entertain the petition here in controversy; and in the exercise of its discretion, to grant or deny the prayer of said petition upon the merits thereof."

Grand Boulevard Inv. Co. v. Strauss, 78 F. 2d 180, at 185.

As to the nature of the court's exclusive jurisdiction and the summary jurisdiction, see Vol. 6, Collier, 14th Ed., beginning at pages 576 to 595.

A litigant otherwise entitled to object to the summary jurisdiction of the bankruptcy court may consent to the summary jurisdiction, just as J. D. Amend has done, thereby giving the bankruptcy court jurisdictional power to summarily determine the issues involved. See Vol. 6, Collier, 14th Ed., pages 595 to 598, and citations thereunder.

At page 595 of the above citation it is pointed out that prior to the enactment of Chapter X in 1938, the court had summary jurisdiction under Section 77B where consent was given by the litigant who could have otherwise demanded a plenary suit, and after calling attention to the fact that Chapter X of 1938 expressly made Section 23 of the Bankruptcy Act inapplicable in reorganization proceedings, says that Section 2A(6) and (7) gives the court this power. See page 596 of the above citation.

If J. D. Amend, who had possession and control of the property in question for himself and as agent for the debtor, had contested the right of the debtor to this property and had objected to the summary jurisdiction of the bankruptcy court to hear and determine the issues, an entirely different, although not fatal, question would be before the Court. But instead of J. D. Amend objecting, he is consenting to the summary jurisdiction of the Bankruptcy Court and conceding that the bankrupt does have a substantial interest in this property, which it has partly paid for by paying Baker & Taylor $60,000.00 for drilling this gas well, and Amend requests the Court to determine this interest.

While it is conceded by the Trustee that J. D. Amend signed the drilling contract with Baker & Taylor to drill this well and thereby became liable for the amount due under the drilling contract, yet the evidence shows that J. D. Amend took the $20,000.00 check of Tri-State of December 15, 1962, which was payable to Baker & Taylor Drilling Co. and earmarked for the drilling on Section 2, handed it to the Secretary of the company, Roy Bulls, and told him in effect that he had made an agreement with Tri-State to pay this drilling cost for an interest in this property, and if Tri-State failed to send these payments (payments on the Section 2 contract) that he wanted to know about it, because he thought he had someone else whom he could sell it to. Within a few days Roy Bulls, the Secretary, called J. D. Amend and told him that the company had received the three $20,000.00 checks, or $60,000.00, which statement lulled Mr. Amend into a sense of security and according to the uncontradacted testimony of Amend, he was not informed that Baker & Taylor

had applied a portion of this $60,000.00 to an old indebtedness of Tri-State for the drilling of the well on Section 54 until the following May. (See testimony of J. D. Amend hereinafter quoted.)

The fact that Baker & Taylor knew of the agreement between J. D. Amend and debtor is apparent for the reason that the first (December 15th) $20,000.00 check from Tri-State was applied upon the Section 2 Amend account, and when Baker & Taylor found a surplus of $9,963.37 from the December 20th check of Tri-State, after paying the old account of Tri-State in full, it without further authority or question applied this balance upon the J. D. Amend account for the drilling of the Section 2 well. Certainly Baker & Taylor would not have been using this money of Tri-State to pay a debt of J. D. Amend unless it had been previously told so to do, knew all about the transaction, and approved of the Amend-Tri-State agreement. It also knew that this same agreement had prevailed between Amend and Tri-State on the two previously drilled wells, and that Tri-State had paid the drilling costs. (See testimony of J. D. Amend and Roy Bulls, Appendices 10 and 11, Appellant's brief, and testimony hereinafter set out in Appellee's brief.)

Inasmuch as some of the Tri-State checks previously given to it for prior drilling had bounced (the $30,000.00 check) it realized that the credit of J. D. Amend was better, and that it had better try and settle the Tri-State account while it could. It just might possibly get away with it.

Baker & Taylor, whose only claim is that of a secured creditor upon property admittedly belonging in part to the estate, has no standing to object to the summary ju-

risdiction of the Bankruptcy Court's determination of the amount and validity of its secured claim. It is not an adverse claimant, holding property adversely to Tri-State. Amend is not an adverse claimant to Tri-State, because he admits Tri-State's interest, and also consents to summary jurisdiction.

We have heretofore, on pages 16-19 of this brief quoted from Vol. 6 Collier, 14th Ed., pp. 571, 572 and 573, and we have italicized on pages 17-18 of this brief the statement to the effect that after the filing of the petition in bankruptcy, district courts, as courts of bankruptcy, are vested by Section 2 of the Act with exclusive and paramount jurisdiction—within the limits fixed by the Act—(and the limit fixed by the Act under Chapter X is property of the debtor, wherever located) to administer the bankrupt's estate wherever located, *to determine all liens and claims pertaining thereto, etc.*

Bankruptcy Courts are constantly passing upon the amount and validity of lien claims of all kind upon the properties of bankrupts in both straight bankruptcies and Chapter X proceedings, liens upon both real and personal property.

Vol. 1, Collier on Bankruptcy, p. 257, No. 2.46 and citations thereunder;

In re Greyling Realty Corp., 74 F. 2d 734;

Continental Illinois Nat'l Bank & Trust Co. of Chicago v. Chicago R.I. & P. Ry. Co., et al., 294 U.S. 648, 55 S. Ct. 595;

In re Cuyahoga Finance Co., et al., 136 F. 2d 18;

Ex parte Baldwin, et al., 291 U.S. 610, 54 S. Ct. 551;

Clark Bros. Co. v. Portex Oil Co., et al., 113 F. 2d 45 (9th C.C.);

Heffron v. Western Loan & Bldg. Co., 84 F. 2d 301 (9th C.C.);

Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734, 51 S. Ct. 270.

Also:

Miller v. Sulmeyer, 263 F. 2d 513;

Moore v. Bay, 248 U.S. 4, 52 S. Ct. 3;

Markwell & Co. v. Lynch, 114 F. 2d 373;

Jubas v. Sampsell, 185 F. 2d 333;

Woodruff v. Laugharn, 50 F. 2d 532;

In re Bowers, 33 F. Supp. 965.

The Bankruptcy Court Had Summary Jurisdiction to Determine the Questions of the Validity and Amount of Valid Liens Standing of Record Against Its Property, Wherever Located.

We fail to see how one can escape the conclusion that the Bankruptcy Court, in a Chapter X proceeding, has unquestioned summary jurisdiction in this Chapter X proceeding, under the broad powers granted by Congress in such cases, to determine the amount and validity of all liens of record against the property, wherever located, in which the debtor admittedly owns and claims a substantial interest.

Debtor had paid to Baker & Taylor $60,000.00 to cover the drilling costs of the gas well, which under the agree-

ment between Amend and the debtor, was a substantial part of the consideration to Amend for a three-fourths interest in this well and lease. The debtor therefore had the right to question the validity of the Baker & Taylor lien and claim, which it had paid with its checks and funds for the very purpose of acquiring an interest in this property.

J. D. Amend had informed Baker & Taylor, through its secretary, Roy Bulls, of the fact that the debtor was paying the drilling costs on Section 2 to acquire this interest, and Baker & Taylor accepted Tri-State Petroleum's checks for this purpose; so the right of the Bankruptcy Court in a Chapter X proceeding to determine the validity and amount of the Baker & Taylor lien and claim against property in which debtor claimed an interest, seems to be abundantly supported by the authorities upon this question.

We respectfully submit that the only person who has a right to dispute or concede a property right in this gas well and lease would be J. D. Amend, and he admits and recognizes Tri-State's interest therein, and it is a property interest within the purview of Section 70a of the Bankruptcy Act, notwithstanding the fact that the lease is still held in the name of J. D. Amend. Furthermore, both Collier on Bankruptcy and the courts emphasize that property which the debtor has *or may claim an interest in* passes under the control of the Bankruptcy Court in Chapter X proceedings.

See:

In re Cuyahoga Finance Co., 136 F. 2d 18 at p. 20.

Jurisdiction as to the Subject Matter and the Person of Baker & Taylor Drilling Company.

The subject matter here, insofar as Baker & Taylor is concerned, is the validity and amount of its claimed lien, which it filed of record against property in which the debtor admittedly has an interest. The filing of this lien by Baker & Taylor upon a property in which the debtor claims and has an interest, gives the Bankruptcy Court jurisdiction under Section 2 of the Bankruptcy Act and Sections 111, 114, 115 and 116 of Chapter X of the Bankruptcy Act, not only to determine the amount and validity of this lien, but to take such other steps and to make such orders by way of injunction or otherwise to protect the Trustee and the bankruptcy estate against unwarranted attacks, which would embarrass the Court or the Trustee in the proper administration of this estate, and in perfecting a Plan of Reorganization. Baker & Taylor, by the recording of this lien upon which the bankruptcy estate has and claims an interest, placed itself in a position where the lien is subject to attack by the Trustee in this Chapter X proceeding. The fact that Baker & Taylor Drilling Co. has its offices and does its business in the State of Texas has no bearing upon the situation in a Chapter X proceeding, even though the property is also located in the State of Texas.

Summary Jurisdiction to Determine Rights as Between Baker & Taylor Drilling Co. and J. D. Amend, and, Summary Jurisdiction to Enjoin Actions by Baker & Taylor Drilling Co. Against J. D. Amend.

The above two points will be presented as one. We concede that the Bankruptcy Court would not have jurisdiction over a dispute between Baker & Taylor and J. D. Amend, where Tri-State Petroleum, Inc. or its property or property rights were not so involved and adversely affected. We also recoginze that the question of summary jurisdiction in such cases presents a question of law more difficult of solution than the mere question of the right of summary jurisdiction over Baker & Taylor where they have filed a lien against property in which the debtor has a substantial interest.

However, the Bankruptcy Court is not impotent to protect its judgments against persons who are involved in a proceeding out of which the bankruptcy judgment arose and who, if permitted to litigate the same matter in another court, might possibly secure a judgment which might and could be the means of impressing a lien or a cloud upon debtor's property and thereby impede or embarrass the proper administration of the bankruptcy estate and the perfection of a Plan of Reorganization. It is obvious that such a lien obtained against J. D. Amend and filed of record in such litigation would adversely affect, impede and embarrass the proper administration of the bankruptcy estate, just as much as if the lien were directly against the debtor itself. The securing of a new lien based upon the non-payment of the drilling costs against J. D. Amend would place the bankruptcy estate right back where it found itself before

the hearing in the Bankruptcy Court and would render wholly ineffective the judgment rendered herein decreeing that Baker & Taylor has no lien. It would be much like clipping a blade of grass for it to grow again. The obligation of the debtor corporation to Mr. Amend to pay the drilling costs would be revived notwithstanding the fact that Baker & Taylor had received Tri-State's checks to pay this cost with full knowledge at the time of the purposes and reason for which these checks were issued.

A State Court judgment against J. D. Amend in this case would more directly and effectively affect the rights of the debtor than it would J. D. Amend, because one of the conditions and considerations of the debtor acquiring full title to this property is its payment of the drilling costs. If Baker & Taylor were permitted to go into state court and were so fortunate as to obtain a judgment against J. D. Amend for a portion of the drilling costs, then J. D. Amend would be justified in demanding of Tri-State Petroleum, Inc. the payment of such a judgment before he delivered title to three-fourths interest in the gas well, notwithstanding the fact that it has already paid the $60,000.00 for this very purpose. So in view of this situation, Tri-State Petroleum, Inc. has a far greater interest in such a suit than J. D. Amend. It is also interested in seeing that further liens are not filed against the property. In either situation the progress of this plan of reorganization and the proper administration of the estate would be impeded and embarrassed and the judgment of the Bankruptcy Court would be wholly ineffective.

This is the very thing of which Collier on Bankruptcy, above cited, speaks when it says that the Bankruptcy

Court may determine all liens and claims pertaining to the property, and has power to prevent by proper order the doing of anything that will at any stage of the proceedings, tend to embarrass or interfere with the Court in the administration and distribution of the estate.

It must be remembered that before any drilling by Baker & Taylor was commenced upon the property in question, J. D. Amend, who held the lease and drilling rights on Sections 56, 54 and 2, entered into an oral contract with the debtor corporation whereby the debtor corporation would acquire a three-fourths interest in each of the properties where wells were drilled, 1st, by the payment of the drilling costs which, on each of the wells, were approximately $60,000.00; and 2d, By paying three-fourths of the costs and expenses necessary to place the wells upon production. That Baker & Taylor knew of this arrangement is obvious from the facts that it did the drilling of each of these three wells and accepted debtor's checks therefor: it executed a drilling contract upon Section 56 with J. D. Amend, *upon Section 54 with Tri-State Petroleum, Inc.*, and upon Section 2 with J. D. Amend. Yet it was Tri-State's checks or money which, in each instance, paid the drilling cost to Baker & Taylor for each well. It was a joint Venture undertaking between J. D. Amend and debtor and Baker & Taylor knew it.

And in this connection the cross-examination of G. D. Bowie, Jr., Treasurer of Baker & Taylor Drilling Co., at page 48, Reporter's Transcript of July 1st and 2, 1964, is interesting and enlightening where, at page 51, line 5, Mr. Bowie said:

> "A. Like I said, the accounts are *synonymous* and the checks were interchanged between the two

companies, and it is very difficult for the bookkeeper to determine where they should go." (Emphasis ours.)

Mr. Bowie, at page 49, line 19, Reporter's Transcript, also testified:

"A. When the check is received, my bookkeeper saw it was from Tri-State and she gave it to the Tri-State account. Analysis later indicated that she made the wrong application."

In each instance where Baker & Taylor and J. D. Amend were involved, Tri-State was also involved, in that it was acquiring an interest in each of the wells drilled by the payment of Baker & Taylor's drilling costs.

Because of evidence such as the above, because of the way in which the last $20,000.00 check was divided between the account of J. D. Amend and that of Tri-State, and because of the conversations between J. D. Amend and Roy Bulls, Secretary of Baker & Taylor, as testified to by J. D. Amend, whose testimony the Special Master found to be true, and based upon the testimony that Roy Bulls called J. D. Amend and told him that his company had received the three $20,000.00 checks, the Special Master came to the conclusion that Baker & Taylor were informed of and knew the purpose for which the three $20,000.00 checks were mailed, and that Baker & Taylor were in effect told at or about the time the checks were received to apply same upon the Section 2 account in the name of J. D. Amend, and that the call from Bulls to Amend that the full $60,000.00 had been received from Tri-State estopped Baker & Taylor from later claiming otherwise.

The three $20,000.00 checks were mailed to J. D. Amend and to Baker & Taylor by Tri-State for the pur-

chase from J. D. Amend of an interest in the gas well pursuant to an agreement of purchase. While these checks were intended to pay an obligation which J. D. Amend owed Baker & Taylor, they were the consideration to J. D. Amend for an interest in the gas well, and it is obvious from all the evidence, including such reasonable inferences as can be drawn therefrom, that Baker & Taylor knew this, and sanctioned and agreed to such arrangement, at least by its conduct in accepting Tri-State's money for J. D. Amend's debt.

Now, if as held by the Special Master, this debt has been paid in full, then it is obvious that Baker & Taylor has no lien claim growing out of the drilling of the well on Section 2 which it can assert against this property which belongs to J. D. Amend and Tri-State, as per the Special Master's ruling.

If Baker & Taylor were permitted to pursue J. D. Amend in an attempt either to enforce its claimed lien or for a money judgment in another court, such action would vitally and adversely affect the rights of the debtor estate, in that a lien against the property by way of a foreclosure or judgment lien would be a lien against the whole of the property, and embarrass and interfere with the proper administration of the debtor estate.

The Bankruptcy Court would in such circumstances have power to stay, by injunction, an action by Baker & Taylor in a state court, upon the same subject matter, in an attempt to obtain a judgment against J. D. Amend different from that rendered in the Bankruptcy Court, because such a judgment would leave the bankruptcy court judgment open to attack and change in a way which would be detrimental to and would frustrate and

impede the proper administration of the bankruptcy estate.

Counsel for Baker & Taylor has quoted from 28 U.S.C.A., Section 2283, at page 25 of his brief, which in effect says that a court of the United States may where necessary in aid of its jurisdiction, or to protect or effectuate "its judgments" stay a proceeding in another court.

We have not examined the above section closely to determine whether it is applicable to a Bankruptcy Court, but we do know that the same rule applies to Bankruptcy Courts. Otherwise, Bankruptcy Courts would be impotent to protect their judgments.

Transaction and Controversy Between J. D. Amend and Baker & Taylor.

We cannot agree with counsel's statement in its brief to the effect that the controversy as between J. D. Amend and Baker & Taylor Drilling Co. is not involved and is wholly unrelated to the issues involved in this bankruptcy proceeding.

We contend that the entire transaction out of which Baker & Taylor's claimed indebtedness arose was a three-party transaction, in which Tri-State was a party, and Tri-State more than ever became an involved party when Baker & Taylor placed a lien upon property in which Tri-State admittedly held and still holds an interest. This is true notwithstanding the fact that the lien claim was asserted against J. D. Amend. It nevertheless became a lien and a cloud upon debtor's property, and it happened to arise from an obligation of Amend which Tri-State had agreed to pay and which, in fact, it had paid.

The Bankruptcy Court, because of Tri-State's interest in this property, had the jurisdictional power under the provisions of Chapter X of the Act to determine the validity and amount of all liens against this property because such a claimed lien adversely affected the rights of the debtor as much, if not more, than it did the rights of Amend, because if Tri-State had failed to pay Baker & Taylor the drilling costs on Section 2 as it had agreed with Amend to do as a part of the consideration for the three-fourths interest in the well, Amend was and is still in a position to hold it to the agreement of purchase.

Since, however, a lien claim was filed and recorded against the property of debtor after Baker & Taylor had accepted the debtor's money to pay this obligation with full knowledge of the agreement between Amend and the debtor, and the Bankruptcy Court has the power to prevent, by proper order, the adverse effect of such a judgment, and to prevent debtor's property and rights to again become involved by any suits which Baker & Taylor might attempt, and in fact are attempting against J. D. Amend.

The above demonstrates what we mean when we say that the Bankruptcy Court is not impotent to protect and effectuate its judgments by injunction, as well as protecting the estate's interest in the property.

Question of Estoppel.

We agree that J. D. Amend signed the contract with Baker & Taylor to drill the well on Section 2 and thereby became primarily liable to pay the drilling costs, and had a right to direct the application of payments on the account. We contend, however, that he had this right re-

gardless of whether or not the payments came directly from him or from another who was obligated to Amend to make these payments, and especially so, where Baker & Taylor was advised of the arrangement and approved of the same by its acceptance of checks from such obligor to Amend.

As we have heretofore stated, when J. D. Amend received the check dated December 15, 1962 for $20,000.00 around the middle of December, 1962 which was made payable to Baker & Taylor Drilling Company and earmarked by a statement on the stub of the check showing that it was intended to be applied upon Section 2 drilling costs, he took this check to Roy Bulls and informed Roy Bulls of his agreement with Tri-State to pay the drilling costs for an interest in the well, delivered the $20,000.00 check to Bulls; told him that he didn't want to carry a further interest in this well, that he couldn't afford to, and if Tri-State didn't come up with the money he wanted to know about it; that he had some other people he thought would buy the interest; that he later had a telephone conversation with Bulls and Bulls said that he had received the third check in the amount of $20,000.00, or a total of $60,000.00.

See Reporter's Transcript of March 24 and 25, 1964, at pages 14 to 20, where J. D. Amend testified:

> "Q. And who signed the contract with Baker & Taylor for the drilling of that well? A. I did. Let me correct that a little bit. I entered into the contract with Baker & Taylor but I'm not sure whether I ever signed the contract or not. But I did enter into a contract with Baker & Taylor to drill that well, and the well was drilled.

Q. By the Special Master: Was there a written contract? A. Yes, there was, but my signature is not on the copy I have.

Q. By Mr. Utley: You are not fighting liability on that? A. No, I am not. I rather think my signature is on the other one. I was trying to establish liability. I did enter into that contract.

The Special Master: Well, the contract itself hasn't any evidentiary value if counsel will stipulate to it.

Mr. Utley: I think the contract is already in evidence, is it not?

The Witness: Yes, it is.

Q. By Mr. Utley: When was the drilling of this well commenced on Section 2? To refresh your memory, it was December 2nd, was it not?

A. Section 2, yes, December 2nd.

Q. And when was it completed? A. About 22nd, as I remember it.

Q. What were the approximate drilling costs costs on the well on Section 2? A. The cost was $58,200.00, or $57,200.00, I don't know which, one or the other.

Q. During the month of December, did you receive a check from Tri-State Petroleum? A. Yes, I did.

Q. On or about what day, do you know? A. It was about the middle of December.

Q. And was that check made payable to you or to someone else? A. It was made payable to Baker & Taylor Drilling Company.

Q. And what did you do with that check? A. I took it to Baker & Taylor and turned it over to Baker & Taylor.

Q. Who in Baker & Taylor's office did you turn it over to? A. I turned that check over to Roy Bulls.

Q. And who is Roy Bulls? A. He is connected with the company, I believe probably as a vice-president. But he is one of the officials of the company.

Q. Do you know whether or not this is the check you turned over to him (indicating)? I am referring to check No. 00142 drawn on the Greenfield State Bank by Tri-State Petroleum, Inc., and signed by Mr. Buntin and Mr. Schlittler, and payable to Baker & Taylor in the sum of $20,000.00. A. Now, there are three of these checks, and the dates on these checks are close together, and I did take one of these checks and turn it over to Baker & Taylor; but as to which one I did, I can't definitely say. I don't recognize which one it was.

Q. Was there a stub on the one you turned over? A. I'm not sure about it.

Mr. Utley: Let's open that deposition.

The Special Master: All right.

Mr. Berry: It will be Exhibit 13, Mr. Utley.

The Witness: I will say this, I believe that there was a stub on that and it was marked 'Section 2,' but—

Q. By Mr. Utley: I hand you Exhibit 13 of the deposition, which is a photostat of a check dated December 15, 1962, for $20,000.00, payable to Baker & Taylor Drilling Company, drawn on the Greenfield State Bank, $20,000.00, and the stub says, 'On account Section 2 $20,000.00.' A. Yes, I attested to that and I said I believed that was the check I turned over to Baker & Taylor.

Q. Now, at the itme you turned that check over to Mr. Bulls, or Baker & Taylor, did you have any conversation about the payment of the drilling costs by Tri-State? A. Yes, I did.

Q. And was anyone else present other than you and Mr. Bulls, at the time? A. No, I believe not.

Q. And where was the conversation held? A. It was in the office of Baker & Taylor Drilling Company.

Q. And what was that conversation? Will you relate it? A. We were both aware of some of these checks that hadn't been paid, from Tri-State.

Q. You mean some had bounced? A. Yes; and and I told Roy, that is Roy Bulls, that I didn't want to carry a further interest in this well, I couldn't afford to, and that if Tri-State didn't come up with the money, or Mr. Schlittler or whoever was supposed to furnish the checks, that I wanted to know about it, that I had some other people I thought would buy my interest.

Q. Did you tell him how much they were supposed to pay? A. Yes, I did.

Q. What did you tell him? A. $60,000.00; and he told me that he would notify me as to whether he got the checks or not.

Q. Did you later have a conversation with him? A. Yes, I did.

Q. And was it personally or by telephone? A. It was by telephone. He called me and told me that he had received the third check in the amount of $20,000.00, or a total of $60,000.00.

Q. Now, I am going to show you—

The Special Master: Shall we take these one at a time? You haven't got the first check or the stub in yet.

Mr. Utley: Well, we do not have the attachment of the stub; but they are in evidence.

The Witness: They are all in evidence.

The Special Master: The check will be received, No. 00142, for $20,000.00, drawn on the Greenfield State Bank by Tri-State Petroleum, Inc., payable to Baker & Taylor Drilling Company, Exhibit 5; and Exhibit 13 attached to the deposition will be marked as Trustee's Exhibit 6 by reference to the deposition.

Q. By Mr. Utley: Now, I am going to show you a check dated December 17, 1962, in the sum of $20,000.00, payable to Baker & Taylor Drilling Company, signed by Tri-State Petroleum, Inc., by Mr. Schlittler and Mr. Buntin, drawn on the Greenfield State Bank. It appears to have been paid on 12-18-62. Have you seen that check before? A. No, I haven't. I have seen a photostat of that, but I haven't seen that check.

Q. You didn't personally handle that check? A. No, sir.

Q. If it was mailed, it was mailed direct to Baker & Taylor and not through you? A. No. I can say definitely I didn't handle it, and I believe the other one was the one I handled.

Q. Here is check 00156, drawn on the same bank, signed by the same parties, payable to Baker & Taylor. Did you personally handle that check? A. I believe not, no. I believe the status would be the same as on the other check that was sent direct.

Mr. Utley: Do you have any objection to offering the originals in evidence? The photostats are in, but I thought we might as well have the originals in.

Mr. Berry: No objection.

Mr. Utley: I would like to offer them, Your Honor, as exhibits next in order.

The Special Master: The check 127, dated December 17th, will be Trustee's Exhibit 7, and check No. 156 dated December 20th will be No. 8.

Q. By Mr. Utley: Mr. Amend, was there any particular reason why you told Mr. Bulls if this $60,000.00 was not paid you wanted to know about it? A. Yes, there was. As I just stated, I wanted to do something else with this—

Mr. Berry: If it please the court, I didn't understand that to be a question as to what he told Mr. Bulls.

Mr. Utley: Well, I think he has answered the question.

Q. Now, did you tell Mr. Bulls what the reason was? A. Yes, I told him.

Q. What did you tell him?

The Special Master: Just state the conversation between yourself and Mr. Bulls.

The Witness: I told him this, that I didn't want to carry that interest myself, and unless it was paid off by these people that I wanted to sell the interest elsewhere.

Q. By Mr. Utley: And then is when he told you he would let you know if the checks— A. He agreed to let me know if and when he received the checks.

Q. If he had informed you contrary to the fact that the $60,000.00 had been paid, did you have another place to sell that interest?

Mr. Berry: This is immaterial, please the court.

The Special Master: Sustained."

It is our contention that the only reasonable inference which can be drawn from the above testimony is that Amend told Roy Bulls, who was Secretary of Baker & Taylor Drilling Co., [see R. Tr. July 1-2, 1964, p. 66], that he had entered into an agreement to sell Tri-State an interest in this well on Section 2 and that the consideration to be paid of $60,000.00 was to come from Tri-State in the form of payment to Baker & Taylor of these drilling costs in the total sum of $60,000.00, and if it wasn't paid, Amend wanted to be informed because he didn't want to carry this interest himself and he had some other people he thought would buy it; that Bulls promised to keep him informed, and in fact later called Mr. Amend and told him that he had received the third check of $20,000.00 or $60,000.00.

If this isn't the equivalent of saying to Amend that the drilling cost on the Section 2 well had been paid, then I frankly do not know what to call it. Amend later testified that he was not informed that some of this money had been applied on the old Tri-State Account until about May 1, 1963. [See R. Tr. March, 1964, p. 73, lines 3-6; R. Tr. July, 1964, p. 95, line 26.]

Furthermore, the testimony of G. D. Bowie Jr., R. Tr. of July 1st and 2nd, 1964 beginning page 48, line 11 to line 4, page 56, shows the confusion which existed as to the entries of Tri-State's checks by Baker & Taylor, and that it considered Tri-State's account and that of J. D. Amend synonymous.

Testimony of Roy L. Bulls.

While Mr. Bulls wavered on some of the points in question and seemed to be confused, there was one thing on which he agreed with Mr. Amend and that was that they had an understanding to keep each other informed,

and that he did inform Mr. Amend about having received the other two checks of $20,000.00 each.

Mr. Bulls says that he had conversations with Mr. Amend about receiving $20,000.00 checks [Tr. p. 72, line 9.] At page 73 of the transcript the conversations were "before the time of the completion of the Wilbank's well" and he thought they were "in J. D.'s office," that no one was present except he and Mr. Amend. That "it was agreed between J. D. and I that he should —that should he get any moneys in payment of the drilling he would let me know, and if any should come to us I would let him know." [Tr. p. 73, line 19.]

While Mr. Bulls says this referred to the Nusbaum well, he immediately thereafter said it referred to all three wells, and was over a period of time. At the beginning of page 73 of the transcript, the Wilbanks well, which is Section 2, was specifically referred to.

On page 74, lines 19 to 21, the conversations were short and "usually in connection with or at the same time as one of the progress reports." He says he made one trip down to Amend's office about getting money specifically on the Nusbaum well [Tr. p. 74, lines 25-26] but that was "*before* the commencement of the Wilbank's well." (Emphasis ours) [Tr. p. 75, lines 1-3.]

All costs on the drilling of the well on Section 56 had been paid. Therefore, any conversation about money during the drilling of the Wilbank's well was about that one well.

At page 77, line 18 of the transcript, Mr. Bulls was asked the following questions, to which he gave the following answers:

> "Q. Was it by telephone or in person? A. By telephone.

Q. Was it more than one time, or do you know? A. I think on two occasions checks were received in our office and I called J. D. and told him the checks had been received."

This was before the completion of the Wilbank's well. [Tr. p. 77, line 26.]

At Tr. page 78, line 24, Mr. Bulls says:

"I probably stated it (the check) was from Tri-State." He says this was per our agreement "mine and J. D.'s agreement." [Tr. p. 79, lines 1-7.]

At Tr. page 80, line 2, Mr. Bulls says:

"I remember I think calling him on a *second check* that we received in the mail." — (Emphasis ours) —"That we had received a check for $20,000.00." He testified [Tr. p. 80, line 14] that Mr. Bowie merely told him that *the checks* were in.

We submit that the words "the checks" refer to the two $20,000.00 checks which had been mailed directly to Baker & Taylor. Mr. Amend delivered the one that was mailed to him.

Mr. Bulls says that he *does not think* that he told Mr. Amend that any money had been paid on the drilling contract on Section 2 [Tr. p. 82, line 21] but he does not testify positively. When Amend talked to him at the time the first $20,000.00 check was delivered, they were talking about the present drilling cost on Section 2, and any subsequent conversation about Tri-State's payments, especially in three separate sums which would equal the costs of the drilling of the Wilbank's well, should be understandable in ordinary everyday language.

It will be recalled that Mr. Bulls said he went to Amend's office once about payments on the Nusbaum well [Tr. p. 74, line 25.] At [Tr. p. 83, line 11] Mr. Amend gave to Mr. Bulls two checks of $5,000.00 each (these checks are in evidence) from Tri-State in payment on the Nusbaum well.

Mr. Amend never told Mr. Bulls that he would pay for the drilling of the well on Section 54. [Tr. p. 84, line 24.] Mr. Amend did agree to pay for the drilling of the well on Section 2 if Tri-State did not. [Tr. p. 85, lines 1-8.] Amend signed the contract for the drilling of the well on Section 2.

Mr. Bulls never told Mr. Amend what the balance was on Section 54 well. *He did not know.* [Tr. p. 86, line 6.] *For all he knew, when Mr. Amend gave him the two $5,000.00 checks from Tri-State* [Tr. p. 83, line 11], *that could have paid all that was due on the Nusbaum well.*

Mr. Bulls was asked [Tr. p. 88, line 24, to p. 89, line 26.]

> "Q. Now, did you call him up when two separate checks came in for $20,000.00 each, didn't you? A. Yes.
>
> Q. And you knew that one $20,000.00 check had been delivered to the office, didn't you, by Mr. Amend? A. Yes.
>
> Q. And didn't you tell him when you got the last $20,000.00 check through the mail that you had received the $60,000.00, three checks for $20,000.00 each? A. I never mentioned the total figure.
>
> Q. But you knew there were three $20,000.00 checks that came in about that time, didn't you? A.

I remember three $20,000.00 checks being involved, yes.

Q. And you mentioned that to Mr. Amend, didn't you? A. I don't remember mentioning that to him. I merely remember making the two separate calls telling him that a $20,000.00 check had been received each time.

Q. And didn't you tell him that you had received the full $60,000.00? A. No, sir.

Q. Well, you received the $60,000.00 at that time, hadn't you? A. I guess we had.

Q. And your understanding with Mr. Amend was that if he got in checks he would let you know and if you got in checks you would let him know, is that right? A. Yes, that was my understanding."

REPLY TO APPELLANT'S BRIEF.

Appellant under the heading of "Statement of the Case" makes incorrect and misleading statements as to the facts of the case. At pages 15 and 16 of its brief, in referring to the checks dated December 17th and 20, 1962 for $20,000.00 each from Tri-State Petroleum, Inc., it says: "Baker & Taylor received no direction from anyone as to how it should be applied." We submit that the quoted conversation between J. D. Amend and Roy Bulls was sufficient to convey to the Secretary of Baker & Taylor the fact that Tri-State was sending the money with which to pay the drilling costs on the Section 2 well, and the telephone calls from Bulls to Amend clearly indicated that it had been so received, and the Referee-Special Master so found, which is ample under General Order 47.

The deposit of the check dated December 17th on December 13th is admitted. (Brief, p. 15.) Baker &

Taylor, therefore, made application of this check to the Tri-State account four days before its authorized date.

Also, Appellant attempts to excuse the application of the check dated December 17th because "Tri-State Petroleum, Inc., did not owe Baker & Taylor Drilling Co. any debt at the time of the receipt of check No. 127 except for the drilling of the Nusbaum well.

Yet, according to Appellant, it without any direction, applied $9,963.37 of the $20,000.00 check of Tri-State toward the payment of the J. D. Amend account for the drilling of the well on Section 2 on December 17, 1962, the very day that No. 127 was dated. This application on the J. D. Amend account was not made until the old Tri-State account was paid in full, but where, may we ask, did Baker & Taylor get authority or sanction to apply money belonging to Tri-State to the Amend account, except through the conversation between J. D. Amend and Roy Bulls. This is evidence of the fact that the company knew on the date the check No. 127 was dated that it was Tri-State's intention to pay the drilling costs of Section 2 with these three $20,000.00 checks.

Baker & Taylor did not know of any account owing to it by Tri-State on December 13th, except the old Section 54 account, if Appellant is to be believed, yet by December 17, the day that check No. 127 was dated, it applied $9,963.37 of another check received from Tri-State to J. D. Amend's account, and at a time the Amend account was not due.

We do not believe that the treasurer of Baker & Taylor would have been quite so careless with Tri-State's funds had he not known the intentions and understandings between Tri-State, Amend and Roy Bulls. Neither

did these excuses impress the Special Master, as shown by the Findings.

Appellant's assertion (Brief, p. 17) to the effect that: "Any interest of Tri-State Petroleum, Inc. in or to the well located on Section 2 or the leasehold estate under which it was drilled must arise, if at all, from a letter of J. D. Amend dated February 11, 1963, addressed to H. F. Schlittler."

We wish to call the Court's attention to the fact that in addition to the letter, both J. D. Amend and H. F. Schlittler have testified to the agreement, and pursuant to said agreement Tri-State Petroleum, Inc. has paid the $60,000.00 drilling costs to Baker & Taylor.

Again, at page 19 of Appellant's brief, Appellant mentions the report of the Trustee filed August 9, 1963 regarding some 20½% interest in this property belonging to the estate. Again, we say that this report was not offered in evidence or taken into consideration by the Referee-Special Master in determining the issues and if it was, the Findings of the Referee-Special Master were contrary to the report. We repeat that the Referee's records will show that the persons promised percents in this well and lease have long since availed themselves of the right to pursue their remedy by the filing of claims in bankruptcy, which have been allowed, under the theory of the law announced in *Woods et al. v. Deck,* 112 F. 2d 739, giving them such a right. They cannot have both the percents promised and allowed claims.

Appellant seems to be concerned over the fact that by the time all liens and claims are paid against the property involved, the debtor will have nothing left. That need not concern Appellant, since the Trustee is satis-

fied that the value of the property is worth fighting for. It would be worth much less if Baker & Taylor were paid twice for one debt.

As to appellant's argument in the last paragraph of page 19 and page 20 of its brief, we submit that the Special Master and the District Court in the Findings have pretty well spelled out what the interest of the Trustee in the property is, and how and why that interest exists, and why Appellant does not have a valid lien against the property.

Baker & Taylor do not have a valid claim against J. D. Amend. It accepted money from Tri-State Petroleum, Inc. to pay for its cost of drilling the well in question with full knowledge that Tri-State was paying the drilling costs in order to acquire an interest in the well from Amend, and the Court so found upon adequate proof. Amend stands ready to convey the property. [R. Tr. March 24-25, 1964, p. 23, line 26, to p. 24, line 3.]

Appellant's Specifications of Error.

We do not propose to take the time, or to impose upon the Court 98 separate answers to assignments of error which could have very well been covered in a few assignments of error. We believe that we have already covered most of the assignments of error raised with the possible exception of insufficiency of evidence to support the Findings.

If we appear to repeat ourselves in our argument, it has been made necessary in answering the numerous assignments of error.

Finding of Fact No. II.

This Finding is supported by the testimony of J. D. Amend [R. Tr. March 24-25, 1964, beginning p. 13, line 20] and the testimony of H. F. Schlittler [R. Tr. March 24-25, 1964 beginning p. 163, line 16] and by the letter from J. D. Amend of February 11, 1963 which is set forth in full in the Trustee's Application, Appendix No. 1. See also R. Tr. March 24-25, 1964, p. 23, line 20, to p. 24, line 3.] A question arose as to whether Amend had an assignment of the lease from Phillips Petroleum [R. Tr. March 24-25, 1964, p. 30], but Phillips Petroleum has never refused to make an assignment.

Finding of Fact No. VI.

This Finding is likewise supported by the evidence cited above.

Finding of Fact No. XIII.

This Finding is supported by the evidence cited above which supports the other Findings.

Finding of Fact No. XV.

This Finding, except for the exception in the last line thereof, was requested by the Appellant. The exception is in line with and is supported by the evidence.

Finding of Fact Set Forth in Assignment of Error No. 34.

This Finding is entirely proper. We have hereinabove pointed out that on December 17, 1962, Appellant, without any apparent direction other than that coming from J. D. Amend to Roy Bulls on or about December 15th, gave the J. D. Amend account credit for $9,963.37 out of the last $20,000.00 check received. Baker & Tay-

lor certainly would not have applied Tri-State's money on the payment of J. D. Amend's debt without some authority from somewhere.

Assignment of Error No. 36 and 37.

The Findings of Fact complained of in the above assignments are proper and are supported by the evidence above cited. Roy Bulls admits that after the three $20,000.00 checks had been received, that he so informed J. D. Amend and Amend also testified to this fact and to the fact that he was not informed differently until sometime in May, 1963. [See Amend's testimony quoted by Appellant in its Appendix No. 10, bottom of p. 5.]

Assignment of Error No. 38.

This Finding here complained of is based upon the testimony that Tri-State paid Baker & Taylor a total of $60,000.00 for the drilling of the well, and from Mr. Bowie's testimony that the total drilling cost was only $57,200.00. [See R. Tr. March 24-25, 1964, p. 106, line 17.]

Appellant's Argument No. V, Page 47 of Brief.

Answering Appellant's argument beginning at page 47 of its brief, Appellant again refers to a report filed by the Trustee in Bankruptcy which was not, to our knowledge, offered in evidence by reference or otherwise and which the Special Master did not consider. And, in any event, the Referee found to the contrary of said report. The Referee's Finding as to the debtor's interest was in keeping with the evidence received to the effect that the debtor was to receive, and will receive upon the payment of three-fourths of certain costs and

expenses a three-fourths interest in the gas well and lease, as per letter of February 11, 1962.

This property was being held by J. D. Amend for himself and Tri-State Petroleum, Inc. as their interest may appear, at the time of bankruptcy. Amend's claim was not adverse to that of Tri-State Petroleum, Inc. Amend and Tri-State's interests were those of joint adventurers. Webster's New International Dictionary, Second Edition, Unabridged, in giving a definition of joint adventure, says:

> "A partnership or co-operative agreement between two or more persons, which is restricted to a single specific undertaking. Sometimes called also joint undertaking or joint venture."

Vol. 28, Cal. Jur. 2d, p. 475 defines a joint adventure as:

> "An undertaking by two or more persons jointly to carry out a single business enterprise for profit. It is in the nature of a partnership, but is a looser form of association and falls short of a partnership. The relationship of joint adventurers has been defined to be that of a mutual agency akin to a limited partnership."

> "Each member of the joint venture is the agent of the others in transaction of its business."

Engineering, etc. Corp. v. Longridge Inv. Co., 153 Cal. App. 2d 404 at 411.

> "Relationship of joint venturers is that of a mutual agency, akin to limited partnership."

Leming v. Oil Fields Trucking Co., 44 Cal. 2d 343.

See also:

Lantz v. Stribling, 130 Cal. App. 2d 476;

Campagna v. Market Street Railway Co., 25 Cal. 2d 304;

Elias v. Erwin, 129 Cal. App. 2d 313;

Buckley v. Chadwick, 45 Cal. 2d 183;

28 Cal. Jur. 2d, p. 491, Sec. 10.

Roy Bulls says: [R. Tr. July 1-2, 1964, beginning p. 75, line 7] that Amend was the only man we ever had any dealings with, with respect to either of the three wells. [See also same transcript, p. 85, line 13] so Amend was also the agent of Tri-State. Roy Bulls also says: [R. T. July 1-2, 1964] they never billed Amend for money owing on Section 54, and he didn't know what, if anything, was owing on Section 54. [R. Tr. July 1-2, 1964, p. 85, line 20, to p. 86, line 6.] [R. Tr. July 1-2, 1964, beginning p. 51, line 19.]

So it is apparent that Amend, who had possession of the property in question, was holding the same for himself and Tri-State Petroleum, Inc. who were joint adventurers, and he definitely had no adverse interest to that of Tri-State Petroleum, Inc., but conceded the entire interest claimed by Tri-State.

The law cited by Appellant in its brief, beginning on page 47, is not helpful to Appellant's contention because of the difference in the facts found to be true in this case.

Statements of the law in decisions by Courts are based upon the facts of the particular case. We submit that the Special Master's Findings of Fact must be accepted under General Order 47, and under said Findings

the Special Master had summary jurisdiction of the issues in question.

In re Standard Gas & Electric Co., 119 F. 2d 658, cited by Appellant in support of its contention (Brief, p. 52) says:

> "The jurisdiction which is exercised by courts of bankruptcy in summary form has uniformly been held to extend only to the person of the bankrupt and to property in his possession or *in the possession of third persons who do not claim adversely to him or whose claims are colorable only.*" (Emphasis ours.)

Also in Appellant's quotation from *Taubel-Scott-Kitzmiller Company, Inc. v. Fox,* 264 U.S. 426, 44 S.Ct. 396, ... L. Ed. 770, on page 52 of its brief, it is said

> "Hence, even if the property is not within the possession of the bankruptcy court, Congress can confer upon it, as upon any other lower Federal court, *jurisdiction of the controversy, by conferring jurisdiction over the person in whose possession the property is.*" (Emphasis ours.)

The case of *Bay City Shovels, Inc. v. Schueler,* 245 F. 2d 73, cited by Appellant is not in point because of the difference in the factual situation.

Transaction Between Baker & Taylor and J. D. Amend Is Not Wholly Unrelated to the Purposes of the Bankruptcy Act or the Purposes of the Debtor Proceeding.

Appellant cites Collier and Remington in support of its theory that the action here taken is wholly unrelated to Tri-State or the bankruptcy proceeding. This is a false factual theory under which Appellant is laboring.

We have pointed out above that the relationship of J. D. Amend and Tri-State Petroleum is that of joint adventurers, and that J. D. Amend, in acting for the joint benefit of the venture, acted as the agent of Tri-State Petroleum, Inc. Here, we have an agreement between J. D. Amend and Tri-State that Tri-State will pay the drilling costs of Baker & Taylor in consideration for an interest in the venture. Tri-State contends and has proven to the satisfaction of the Special Master and the District Court that it has already paid the same.

Baker & Taylor is not content with this ruling and seeks state court action against J. D. Amend who signed the contract to recover what it still contends is due. We have already pointed out why and how such litigation, if successful, is far more detrimental to Tri-State than it would be to J. D. Amend.

We repeat that if such a judgment were secured against J. D. Amend, Tri-State would have to satisfy same in order to be entitled to receive a three-fourths interest in this well, notwithstanding that it has already secured a judgment against Baker & Taylor, based upon ample evidence under General Order 47, that the claim has been fully paid by it.

So we see that the Trustee and the estate has a vital interest in stopping further court action in this matter.

The delay already caused and the uncertainties of the outcome have already damaged the bankruptcy estate through the difficulty of obtaining a buyer under the circumstances, and has impeded and embarrassed the administration of the estate and the perfection of a Plan of Reorganization. Further litigation will be highly detrimental to the estate.

With reference to J. D. Amend directing application as to how the funds were to be applied:

When he told Roy Bulls that Tri-State had agreed to pay these costs (drilling costs) and if it did not do so, he wanted to know it, because he had someone else he could sell it to, and that he couldn't afford to carry it himself, and in answer thereto, Roy Bulls called him and told him his company had received the two checks for $20,000.00 each in addition to the one delivered by Amend; that in addition thereto, the one delivered by J. D. Amend was marked "Section 2," we believe the Court was justified in concluding that this was the equivalent to a direction, and that Roy Bulls knew what was intended by Amend's statement, and especially when neither Amend nor Bulls knew at the time that there was a balance due from Tri-State on the Section 54 contract, or on other indebtedness except the drilling costs on Section 2.

Amend Was Not Aware and Not Informed That All of the Drilling Costs of Section 54 Had Not Been Paid Until Some Time in May, 1963.

Upon the above subject matter, Amend at page 13, lines 10-19, March 1964 R. Tr., testified:

> "Q. Now, do you know whether or not all of the drilling costs were ever paid on that well? A. No, I don't.
>
> Q. Were you prior to December 20th of 1962 ever informed by Baker & Taylor, or anyone else, that the drilling costs had not been paid? A. No, I was not.
>
> Q. Were you laboring under the impression they had been paid? A. Yes."

and again, at page 72, line 19, to page 73, line 6, March 1964 R. Tr., Mr. Amend testified:

> "Q. By Mr. Utley: Did Mr. Bulls at that time advise you of any other indebtedness owed by Tri-State to Baker & Taylor? A. No.
>
> Q. Did Mr. Bulls at any time advise you that a portion of the three $20,000.00 checks had been applied on some preexisting indebtedness? A. No.
>
> Q. When did you first learn that it had been applied on some preexisting indebtedness? A. Well, it was some months later, or some weeks later, probably along in May or some time about that time.
>
> Q. You mean the following year? A. Yes, 1963."

We have already quoted and referred to testimony of J. D. Amend, Roy Bulls and H. F. Schlittler, which supports the Court's Findings and Conclusions of Law complained of on pages 66 to 69 of Appellant's brief.

Finding of Fact No. XXV.

This Finding is supported by the testimony of J. D. Amend and H. F. Schlittler above cited.

Findings of Fact No. XXVI and No. XXVII.

These Findings are certainly established by the evidence above cited, and the records and Exhibits before the Court.

Conclusions of Law.

The Conclusions of Law made by the Court are all proper and based upon the Findings of Fact made by the Court.

Conclusion of Law No. XIII only prevents Baker & Taylor from pursuing its action in the State Court against J. D. Amend or Tri-State based upon its claim of an alleged balance due for the drilling of the gas well on Section 2. Such an action against J. D. Amend, as we have hereinabove pointed out, would vitally affect the rights and interests of debtor, and impede and embarrass the proper administration of the debtor estate.

When Collier on Bankruptcy, cited by Appellant on page 54 of its brief, said "*Ordinarily* a court of bankruptcy will not take jurisdiction of a controversy between two parties over a matter concerning which the Trustee of the bankrupt estate *has no interest*" [emphasis ours] it certainly was not referring to a situation where the trustee of a bankrupt has an admitted and conceded right, under the terms of an agreement, to a three-fourths interest in an oil well by the payment of an additional $40,000.00, or if the well is sold, then the $40,000.00 may be paid out of the purchase price. If that isn't a valuable property right under Section 70a of the Bankruptcy Act, then we do not know what to call it, more especially where the debtor already has an investment therein of $60,000.00.

Appellant's difficulty arises from its idea of the facts, rather than the facts found to exist by the Court, based upon ample evidence.

Kaplan & Guttman, 217 F. 2d 481, is not in point because in that case the Bankruptcy Court had previously held that Guttman, the bankrupt, had no interest in the property.

Answering Appellant's argument (Brief, p. 57) to the effect that the debt to it was by J. D. Amend pur-

suant to contract and not by Tri-State Petroleum, Inc. Our answer again is that it was a debt and obligation of Tri-State to J. D. Amend by contract, and an obligation under the law as a joint adventure to both J. D. Amend and Tri-State Petroleum, Inc. See 28 Cal. Jur. 2d, page 489.

The case of *In re Magnus Harmonica Corp.*, 233 F. 2d 803, involved a suit against officers of the debtor corporation who were guarantors of an obligation of the debtor corporation, which case is not in point under the facts of this case.

The court says in the above decision that the only question for it to decide whether the injunction was one which was necessary to protect the jurisdiction of the Bankruptcy Court.

In the case here before the Court, there is a vital and well founded reason for the jurisdiction of the Bankruptcy Court to be upheld.

Without unduly extending the argument on other cases cited by Appellant, suffice it to say that in each of them there is a distinguishing difference in the factual picture.

Estoppel.

Counsel for Appellants and the writer of this brief are agreed on one point, and that is that the Texas law on the question of estoppel and the law of California are substantially the same.

Appellants have cited both Texas and California law upon the question of estoppel and so have we. Our citations of law upon this point appear in our Appendix No. 6

We submit that the evidence which the Court found to be true supports the conclusion of estoppel under the cases and law cited in connection therewith.

While it may be that check No. 127 which was dated December 17, 1962 may have been received on December 13, 1962, it nevertheless was dated Decmber 17, 1962 and Baker & Taylor was without authority to use this check or to apply its proceeds prior to December 17, 1962. By that time it had been advised of the purpose for which these checks were mailed. We have covered this point in prior argument.

The check which Amend received and delivered to Mr. Bulls was dated December 15, 1962 and was delivered on or about that date. It had a notation that it was in payment of Section 2.

But regardless of when the checks were received, Mr. Bulls had led Mr. Amend to believe to his detriment, and to the detriment of Tri-State that the drilling cost on Section 2 had been paid, and neither he nor Tri-State knew otherwise until May and June of 1963. [See R. Tr. March 24, 1964, p. 73.]

Both Mr. Bowie and Bulls testified that the company mailed no invoices which would be a means of notification of any balance due.

Conclusion.

We respectfully submit that the Bankruptcy Court had summary jurisdiction to hear and determine all the matters herein; that the Findings of Fact and Conclusions of Law are amply supported by the evidence and the law of the case, and the District Court was justified in sustaining the Special Master pursuant to General Order 47.

Respectfully submitted,

ERNEST R. UTLEY and
HUBERT F. LAUGHARN,
Attorneys for Trustee.

Certificate.

We certify that, in connection with the preparation of this Brief, we have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in our opinion, the foregoing Brief is in full compliance with those rules.

ERNEST R. UTLEY

APPENDIX NO. 1.

The Application of R. W. Stafford, Trustee of the above entitled estate, respectfully represents:

I.

That he is the duly and regularly appointed and qualified Trustee of the above entitled estate, and has been acting in such capacity since on or about the 24th day of June, 1963.

II.

That among the properties in which the debtor corporation has an interest are certain oil and gas wells and leases located in Hansford County, State of Texas, and among which is a gas well located on the Southeast Quarter of Section 2, Block 1, H&GN Ry. Co. Survey, County of Hansford, State of Texas.

III.

That the predecessor of the debtor corporation, to wit, Midwest Petroleum Corporation, became interested during the latter part of 1961 with J. D. Amend of Amarillo, Texas, in the drilling of certain oil and gas wells in the County of Hansford, State of Texas, and on or about the 29th day of October, 1962, J. D. Amend, acting in behalf of himself and the debtor corporation, entered into an oil and gas lease with Phillips Petroleum Company, a Delaware corporation, with offices at Bartlesville, Oklahoma, for the drilling of an oil and gas well upon the Southeast Quarter of Section 2, Block 1, H&GN Ry. Co., County of Hansford, State of Texas, and as evidence of said agreement between said J. D. Amend and the debtor corporation, J. D. Amend on February 11, 1963 addressed a communication to H. F. Schlittler, 1904 Truxton Avenue, Bakersfield, Califor-

nia, who was then the President of said debtor corporation, which letter sets forth the following:

"Mr. H. F. Schlittler
1904 Truxton Ave.
Bakersfield, California

'Re: Sec. 2, Block 1,
H&GN, Hansford Co.,
Texas

Dear Foy:

This letter will confirm our agreement as to the Cleveland Gas well on the above captioned Section.

You will be assigned a 3/4 interest in this well subject to the customary 1/8 royalty, a 1/32 override to Phillips Pet. Co. and a 1/32 (one thirtysecond) override to the people from whom the deal was obtained. This assignment will be made to you or by the order of you when the well is finally completed and all expenses have been taken care of by each of us as to the percentage which we own.

The agreement with Phillips is enclosed so you will have a thorough knowledge of the transaction and in case you are successful in making a deal with some one on Sec. 2 and also the S/2 of Sec. 56, Blk. 4, T&NO, Hansford County, you can present a true picture of the lease.

This deal will have additional good locations such as a lower morrow on Sec. 2 and an excellent Upper morrow on 56. There are also additional locations for the Marmaton in both leases and especially on Sec. 56. The Phillips Well in Sec. 2 made over 6,000,000 cu ft of Gas natural and was ruined when treated. This zone is a certainty.

The well is cleaning up and we will try to get a potential in the next 4 or 5 days. I have already contacted Northern Natural and we should get a connection in the near future. In line with our telephone conversation, it will be to our mutual advantage to sell this well and our additional interest in 56 so that we can proceed with the development of the BA farmout.

Regards.

"s/ J. D. AMEND"
J. D. Amend"

IV.

That after entering into said lease, drilling operations were commenced and a well was drilled which produced and is capable of producing large quantities of gas and oil. That the debtor corporation for the purpose of drilling said well, advanced large and substantial sums of money to assist in defraying the expenses of drilling said well, as hereinafter more particularly set forth.

V.

That in addition to the monies advanced by the debtor, it appears that certain obligations were incurred which have not yet been paid and satisfied, and certain creditors claim a lien upon said gas well and property, and because of their asserted liens, the Northern Natural Gas Company has refused and is still refusing to purchase and accept gas from said well and by reason thereof, said well is inoperative.

VI.

That among the creditors claiming a lien upon said well and property are the following:

Baker & Taylor Drilling Co., a corporation, with offices at Amarillo, Texas, claims a lien upon said property

in the sum of $27,536.78 by virtue of certain work and drilling operations performed by said company upon said property.

Halliburton Company, a corporation, with offices located at Duncan, Oklahoma, claims a lien upon said property in the total amount of $18,816.11.

Welex, a Division of Halliburton Company, claims a lien in the total sum of $2538.36.

Beacon Supply Company, a corporation, with offices located at Pampa, Texas, claims a lien on said well and property in the total amount of $3709.88.

J. D. Amend paid certain claims against said well and in so doing, created a lien thereon in favor of Upshaw Investment Company in the total sum of $20,000.00 for the purpose of securing funds to pay said claims. It is believed that J. D. Amend may have paid claims against said well in excess of the $20,000.00 hereinabove mentioned.

VII.

Your Applicant is informed and believes and upon such information and belief alleges that during the drilling of said well and during the month of December, 1962, debtor corporation paid directly to Baker & Taylor Drilling Company, a corporation, the sum of $60,000.00, represented by three separate checks made payable to Baker & Taylor Drilling Co. for the purpose of applying same upon the drilling operations upon the aforesaid gas well. That it appears from the alleged lien claim of Baker & Taylor Drilling Co. that credit has only been given for the total payment of $29,363.22. That in addition to the three $20,000.00 checks issued in December, 1962 to Baker & Taylor Drilling Co., it appears from the debtor's records that it also paid Baker

& Taylor Drilling Co. for other drilling operations the sum of $40,000.00 in or about the month of August, 1962. That said Baker & Taylor Drilling Co. has not accounted for the application of the aforesaid funds.

VIII.

Your Applicant is informed and believes and upon such information and belief alleges that Simco, a corporation, located in Amarillo, Texas, claims an indebtedness against the debtor and said property in the total sum of $1050.40, but insofar as your Applicant is aware, Simco does not claim a lien on said property.

IX.

Your Applicant does not have sufficient information upon which to base an accurate determination of the exact amount due each of the aforementioned creditors of the debtor corporation, or as to the validity of the claimed liens on said property, and it will be necessary for the proper administration of this estate that the validity and amount of said liens and claims be determined by this Honorable Court, and that the lien rights of such creditors be transferred to the funds to be received from the production and/or sale of said property, with the same force and effect as they now attach to the property and gas well itself, and so as to permit your Applicant to operate said property and to secure revenue therefrom for the purpose of paying said obligations.

Your applicant is informed and believes and upon such information and belief alleges, that from the operation of said property and from funds which have been promised by certain investor-creditors of the above entitled estate, that said obligations can soon be satisfied in

full. It is quite obvious that no progress can be made in the operation of said property or in the production of gas therefrom, so long as said lien rights attach to the gas to be removed from said well as the Northern Natural Gas Company refuses to purchase or accept said gas so long as liens exist against same.

X.

That your Trustee, in company with one of his counsel, Ernest R. Utley, attended a conference with certain of the above named creditors at Amarillo, Texas, on February 13, 1964, including Max Banks, President of Baker & Taylor Drilling Co., J. D. Amend, Harold Proue, Division Credit Manager of Halliburton Company, at which time all of those present, except Baker & Taylor Drilling Co., agreed to forego any action towards the enforcement of their claims for a period of two weeks, to give the investor-creditors of debtor corporation an opportunity to raise funds for the purpose of satisfying at least 50% of said claims, but the said Baker & Taylor Drilling Co. refused to extend to debtor any time whatsoever, notwithstanding the fact that it was informed that the Judge of this Honorable Court had on or about the 24th day of June, 1963 issued a restraining order, which provides as follows:

> "That until further order of this Court, all creditors and stockholders, and all sheriffs, marshals and other officers, and other respective attorneys, employees and other agents, and all persons, firms and corporations, are hereby jointly and severally enjoined and restrained from, directly or indirectly in any way or manner, commencing or continuing any action, suit or proceeding against the debtor or the trustee in any court or before any adminis-

trative agency or other tribunal, or causing the issuance or execution of any writ, process, summons, attachment, subpoena, claim and delivery, replevin, or other process, for the purpose of impounding or taking possession of or interfering with the possession of, or enforcing a lien upon, any property owned by or in the possession of the debtor or the Trustee; and from doing any act or thing whatsoever, directly or indirectly, in any way or manner, to interfere with the possession or management by the debtor or the Trustee of the property and assets of the debtor's estate; and from interfering, directly or indirectly in any way or manner, with the Trustee in the discharge of any of his duties; and from interfering, directly or indirectly in any way or manner, with the exclusive jurisdiction of this Court over the debtor and the Trustee and all property and interests in property comprising the debtor's estate; and all persons, firms or corporations owning any lands or buildings occupied in whole or in part by the debtor or the trustee, or wherein is contained any property of the debtor's estate, are jointly and severally enjoined and restrained, until further order of this Court, from directly or indirectly, in any way or manner, evicting the debtor or the Trustee, or removing or interfering with the possession or use or removal by the debtor or the Trustee of any such property."

That a copy of said Order of the Judge, incorporating said Restraining Order, was served upon Baker & Taylor Drilling Co. and Halliburton Company. Baker & Taylor Drilling Co. then and there threatened and still

threatens to file a suit for the purpose of the enforcement of their lien upon said property.

XI.

That by reason of the above, your Applicant believes that it would be advisable and for the best interests of this estate, to have this Honorable Court issue its Order to Show Cause upon each of said creditors, requiring them to show cause if any they have, why each of said creditors should not be required to establish the validity of their claims, as well as the validity of any claimed lien to the property hereinabove mentioned, and why the Court should not hold and determine that the debtor corporation has an interest and property right in the gas well and lease herein described, and why any creditor and/or its attorney who has knowingly violated the Restraining Order of this Honorable Court, should not be certified for contempt of court.

XII.

Your Applicant further states that it is his belief that this Honorable Court should direct your Applicant, after notice to the aforementioned creditors, the course which should be pursued with reference to the payment of the aforementioned claims after the exact amounts thereof have been established, as well as the course to be pursued in the operation of said property.

Your Applicant has been informed and believes, and upon such information and belief alleges, that if said gas well is operated, it will eventually, produce for the

creditors of this estate, a sum well in excess of $300,-000.00, and said asset should be preserved for the benefit of the creditors of this estate.

WHEREFORE, your Applicant prays that this Honorable Court issue its Order to Show Cause ordering and directing Baker & Taylor Drilling Co., Amarillo, Texas; Halliburton Company, Duncan, Oklahoma; Welex, a Division of Halliburton Company; Beacon Supply Company, Pampa, Texas, and J. D. Amend, Amarillo, Texas, and each of them, to show cause before this Honorable Court on a day to be fixed, why they, and each of them, should not be required to establish the amount of their claim and the validity of any claimed lien before this Honorable Court, and why any valid liens found to be in existence should not be transferred to the funds received from the operation of said well, or from the sale of said lease and property, and Trustee should not be permitted to operate said property for the purpose of paying off all claims against said property; and doing such other acts as may be required for the preservation of this estate and in its best interests; and why it should not be determined that each of said creditors are amenable and subject to the Restraining Order of this Court, and therefore enjoined from filing or prosecuting any pending litigation against the property herein described until the further Order of this Court, and why each of such creditors should not be required to comply with the provisions of said Restraining Order; and why any of the creditors

or their attorneys hereinabove mentioned who have knowingly violated the Restraining Order of this Honorable Court, should not be certified for contempt of court; and why this Honorable Court should not direct the Trustee in connection with the extent of his operations of said property; and, for such other and further relief as to the Court may seem just and proper in the premises.

Dated this 19th day of February, 1964.

/s/ R. W. Stafford
Trustee

Ernest R. Utley and
Hubert F. Laugharn

By .....
Ernest R. Utley
Attorneys for Trustee"

APPENDIX NO. 2.

Upon reading and filing the application of R. W. Stafford, Trustee of the above entitled estate, and good cause appearing therefor,

It Is Ordered that Baker & Taylor Drilling Company, Amarillo, Texas Halliburton Company, Duncan, Oklahoma, Welex, a Division of Halliburton Company, Beacon Supply Company, Pampa, Texas, and J. D. Amend, Amarillo, Texas, and each of them, or anyone acting for or in their behalf, be, and each of them is ordered to appear before this Court at its courtroom at Room 324 United States Post office and Courthouse Building, Los Angeles, California, on the 28th day of February, 1964, at the hour of 2:00 P.M. of said day, and to show cause if any they or either of them have, why they should not be required at said hearing to establish the amount of their claim, if any, and the validity of any claimed liens upon any property belonging to debtor herein, including the oil and gas well described in the application of the Trustee herein, a copy of which Application is ordered to be served herewith, and why the aforementioned creditors, and each of them, should not be required to abide by the Restraining Order of this Honorable Court issued on the 24th day of June, 1963, a copy of which is set forth in the Application of the Trustee herein; and why any creditor who has knowingly violated said Restraining Order should not be certified for contempt of this Court; and

It is Further Ordered that Respondents herein, and each of them, show cause, if any they or either of them have, why any lien rights shown to exist against said gas well and property should not be transferred to the

funds received from the sale and/or operation of said well, with the same force and effect as they now attach to the property itself; and,

It is Further Ordered that service of this Order to Show Cause and the Application of the Trustee being attached thereto, may be served either personally or by United States mail upon each of the Respondents at their last known place of address; and

It is Further Ordered that in the event any of said Respondents desire to appear and resist this Order, that they, and each of them, be required to file a written answer setting forth their defensive position at least two (2) days before the date of hearing of this Order to Show Cause, and that such answer be served upon the Trustee or his Counsel; and

It is Further Ordered that pending the hearing of the within Order to Show Cause, the aforementioned Respondents, and each of them, are held amenable to the restraining order of the Court, and are restrained from commencing the prosecution of any litigation or from further prosecution of any litigation now pending which seeks a judgment or the foreclosure of any claimed lien against the property of the oil and gas well herein mentioned.

Dated February 19, 1964."

/s/ Ronald Walker
Referee in Bankruptcy"

APPENDIX NO. 3.

TO THE HONORABLE RONALD L. WALKER, REFEREE IN BANKRUPTCY:

J. D. Amend, in answer to the Application of R. W. Stafford, respectfully represents:

I.

That he is the operator and only operator of the J. D. Amend #1 V. W. Wilbanks, 1250′ from the S and E, Section 2, Block 1, H&GN Survey, Hansford County, Texas, and that his interest in this well amounts to twenty-five per cent (25%) of the working interest.

II.

That it is impossible, under present conditions, to produce the well or properly secure title to or assign title to same for the following reasons: On October 29, 1962 Phillips Petroleum Company of Bartlesville, Oklahoma and J. D. Amend of Amarillo, Texas entered into an agreement for the development of the above mentioned gas well. Paragraph II, pertaining to assignment reads as follows:

'In the event the well for which provision is made in numerical paragraph I hereof shall be commenced, drilled and completed to the total depth therein specified, all within the time and in the manner provided in this agreement, and provided that Second Party shall have fully complied with all of the other terms and provisions of this agreement, and provided further Second Party shall have furnished Phillips with evidence satisfactory to it that all bills for labor and material in connection with Second Party's operations have been fully paid, then and thereupon, Phillips agrees, subject to the conditions, exceptions, reservations, covenants and agree-

ments hereinafter set forth, to assign and transfer unto Second Party, without representation or warranty of title, either express or implied, all of its right, title and interest in and to the oil and gas lease (or leases) described in Exhibit "A" insofar as said oil and gas lease (or leases) covers and pertains to the oil and casinghead gas, and all rights pertaining thereto, in the lands specifically described in Exhibit "A".'

III.

That J. D. Amend does not recognize anyone as having any interest in this well until such time as all bills have been paid and H. F. Schlittler, or his successor has so described the manner in which the assignment of the 75% working interest is to be made. The said J. D. Amend does not deny that Tri-State Petroleum, Inc. may be able to establish some grounds for an interest in this well but he merely states that he does not have any way of determining to whom the 75% interest belongs; and also, that J. D. Amend has never had a deal with Tri-State Petroleum, Inc., but that his arrangement was made with H. F. Schlittler, R. S. Fish and J. H. Johnson individually. (Copy of confirmation letters attached.)

IV.

Operator J. D. Amend's 25% interest is free of and is in no way connected with the remaining 75% working interest.

V.

That he does not know to whom the remaining 75% working interest actually belongs even though he is aware that three $20,000.00 checks, or an aggregate of $60,000.00 were received by Baker & Taylor Drilling Company of Amarillo, Texas and sent by Tri-State Pe-

troleum, Inc. of Bakersfield, California; said checks being received by Baker & Taylor Drilling Co. between the date of the signing of the agreement between Phillips Petroleum Company and J. D. Amend and the completion of the drilling of the gas well about the first of January, 1963. The fact that the checks were sent by Tri-State Petroleum Company would not reflect the manner or to whom any interest in this well would actually belong because in the past on other drilling operations covered by the same deal monies were received from other sources at the direction of H. F. Schlittler, and at no time did said checks indicate how the final assignments of interest were to be made.

VI.

J. D. Amend, as the operator, has paid $26,024.69 of the valid claims and bills incurred in the drilling and completion of this well. Of this amount $6,024.69 has been paid from the funds of the said J. D. Amend and as operator he has borrowed $20,000.00 (bearing interest at the rate of 6%) from the Upshaw Investment Company of Amarillo, Texas to pay the balance of the $26,024.69. In addition the following valid bills are to be paid to the following in the amounts herein set forth are past due and legitimate:

A. Halliburton Company, $18,816.11, drawing 7% interest

B. Welex, $2538.36, drawing 7% interest

C. Beacon Supply Company, $3709.88, drawing 7% interest

D. Semco, $1050.49

E. John H. Nicholson, Geologist, $540.00.

The said J. D. Amend states that all of the above mentioned accounts or bills are just and valid. (Copy of Deed of Trust attached).

VII.

That there is also a claim of Baker & Taylor Drilling Co. in the amount of $27,536.78. This claim may or may not be valid and must be determined as to not only its validity but to its extent. The $60,000.00 mentioned above and received by Baker & Taylor before the first of January, 1963 and of which fact Baker & Taylor notified the said J. D. Amend as having received the said amounts and it was the supposition of J. D. Amend that the $60,000.00 would be credited to the drilling contract (a copy of which is herein attached) and it was not until several weeks later that Baker & Taylor notified J. D. Amend that part of the $60,000.00 had been credited to the account of Tri-State Petroleum, Inc. for the drilling of its well on Section 54, Block 4T, T&NO Rr. Survey, Hansford County, Texas; and that they, Baker & Taylor Drilling Co., still showed from their books that J. D. Amend still owed them approximately one-half of the amount of their claim against the J. D. Amend #1 V. W. Wilbanks well and that Tri-State Petroleum likewise owed them a similar even though not an exact amount for the drilling of the well on Section 54 by Tri-State Petroleum, Inc. (Plats showing locations and operators are attached).

VIII.

That there are two things that need to be resolved in this matter (a) the ownership of the 75% working interest other than the operator's 25%; and (b) the validity and the extent of the Baker & Taylor claim in the amount of $27,536.78.

IX.

That the operator J. D. Amend, in cooperation with R. W. Stafford, Trustee and Mr. Ernest R. Utley, his attorney, has endeavored for more than one year, without results, to sell the well at a reasonable profit.

X.

That the delay in getting the gas well into production has worked a hardship on all the valid creditors as well as J. D. Amend the operator. It is also to be noted that the royalty owners interested in this well are being drained by presently producing gas wells on adjacent leases.

XI.

That the said J. D. Amend has offered to sell the well to H. F. Schlittler and also to the Public Securities Holders Committee for a very reasonable and nominal amount and that in both cases the offer was not accepted.

WHEREFORE, the said J. D. Amend prays that this Honorable Court, if it determines this matter to be within its jurisdiction, issue its order determining the validity of and to what extent, if any, the Baker & Taylor claim should be paid; and that it further declare all the claims shown in Paragraph 6C to be just and valid and subject to be paid (all invoices pertaining to these claims have been furnished to H. F. Schlittler and practically all of them have been furnished to R. W. Stafford, Trustee) and that the Honorable Court issue an order whereby J. D. Amend, in cooperation with W. A. Stafford, Trustee, and his attorney, Ernest R. Utley be permitted to continue until successful, his search for an acceptable purchaser of the gas well. That

he be permitted to pay the legitimate bills and divide the proceeds, if any remain, from such sale according to the interest as set out in this answer, and further, that that portion of the monies, if any, belonging to the 75% working interest which has not at this time been determined, be placed in an escrow account subject to its finally being paid to the rightful owners.

Dated this 24th day of February, 1964."

s/ "J. D. Amend"
J. D. Amend"
Operator

APPENDIX NO. 4.

TO THE HONORABLE RONALD L. WALKER, REFEREE IN BANKRUPTCY:

Supplement to J. D. Amend's Petition in Answer to R. W. Stafford, Trustee, in the Matter of Tri-State Petroleum, Inc.

I.

It is absolutely essential that the Bankruptcy Court order that all lien rights shown to exist against said gas well and properties should be transferred to the funds received from the sale of the property.

II.

That it has been shown that the sale of the property is essential and that any further delay will only add to the hardships of the operator, the creditors, and especially the royalty owners in that their properties are now being drained and their only relief is to have the gas well put in operation. That no one would suffer any hardship from the sale of this well.

III.

That the only claim in which there is a question is that of Baker & Taylor Drilling Company in the amount of $27,536.78, and the determination of how this is to be paid will affect no one other than Baker & Taylor Drilling Company and the Investors, along with Tri-State Petroleum, Inc. It is to be noted that the operator, J. D. Amend, has already fulfilled his obligation as to the actual drilling of the well. He is also agreeable to participating in the payment of completion costs to the extent of his interest; and whether Baker & Taylor Drilling Company's claim is declared valid completely or in part will be of no consequence to him.

IV.

It is proposed that the well be sold to a prospective purchaser who is being contacted by the operator at the present time, that all valid bills be paid and that the amount of the claim to Baker & Taylor Drilling Company be placed in escrow, subject to its being paid to the rightful owners at the order of a properly constituted court of law.

Dated this 2nd day of March, A. D. 1964.

s/J. D. Amend"
J. D. Amend
Operator"

APPENDIX NO. 5.

Law of the Case Re Direction of Payment.

44 Texas Jurisprudence 2d, Page 687, says:

> "There need not be an expressed agreement, but a tacit understanding of the parties is sufficient, and their real intention, however manifested or ascertained, is controlling. Whether there was such an agreement is usually a question for the jury. If the creditor fails to apply payments as agreed, or misapplies them, equity will require that they be properly credited, as of the date of payment."

At Page 692, 44 Texas Jurisprudence 2d, Paragraph 37, it is said:

> "Ordinarily the debtor's direction for application must be made at the time of payment, or at least before any controversy as to the matter has arisen. But where, by mistake, the debtor fails to direct the application, and the creditor applies the payments to a debt other than the one intended by the debtor, the creditor should correct the mistake when his attention is called to it shortly thereafter, unless in the meantime something has intervened that would put him to a disadvantage if he did so."
>
> "A direction as to the mode of application may be implied from circumstances."
>
> See: *Bray v. Crain,* 59 Texas 649;
>
> See also: 40 Am. Jur., Page 804, ¶140.

Mr. Amend was the person liable for the payments to Baker & Taylor under the drilling contract for Section 2. He was the debtor and had the right to direct

payments whether they came from Tri-State or whoever may have sent payments. Tri-State's checks were given for the purpose of acquiring an interest from Amend in the well.

It was made known to Mr. Bulls, the Secretary of the company, that Amend expected the payments for the drilling of the well on Section 2 to come from Tri-State, and if they didn't come, he wanted to know it so that he might sell this interest to some one else. He was notified that the three $20,000.00 checks were received, and if that isn't the same as saying that the account had been paid, we are at a loss to know what to call it. It certainly lulled Mr. Amend into a sense of security and kept him from getting other purchasers for this interest. Baker & Taylor by reason thereof is now estopped from asserting otherwise. This estoppel is effective in favor of both Amend and Tri-State. Amend directed Tri-State to send these checks to Baker & Taylor. Rep. Tr., P. 58, March, 1964.

The direction to apply funds ordinarily is made at the time of payment, but may be made under the Texas law which we have cited in the aforementioned Points and Authorities before any controversy as to the matter has arisen, and where by mistake, the debtor fails to direct the application, and the creditor applies the payments to a debt other than the one intended by the debtor, the creditor should correct the mistake when his attention is called to it shortly thereafter. So says Texas Jurisprudence above quoted.

Also, the rights of third parties should be protected. *Temple National Bank v. Blackburn,* 235 S.W. 2d 462;

See also:

Dunn et al. v. Second National Bank of Houston, 113 S.W. 165; 115 A.L.R. 730 at 739.

"Where there is no direction as to the application of a payment, the creditor shall determine how it shall be applied unless the application made is *unreasonable or would work an injustice to the debtor.*"

Bray v. Crain, 59 Texas 649. [Emphasis ours.]

It would most certainly be unreasonable and unjust to permit Baker & Taylor to assert a claim or lien against this property, standing in the name of Mr. Amend, but in which debtor has an admitted interest, after Mr. Amend was led to believe that the $60,000.00 drilling cost to said company had been paid, and was thereby lulled into a sense of security, and was thereby prevented from protecting himself by securing another purchaser for his interest. (See Rep.Tr., P. 73, L. 14 to L. 6, P. 74)

Conceding for the sake of argument, although we are not sure,, that the $20,000.00 check first received by Baker & Taylor from Tri-State was the one dated December 17, 1962, and not the one delivered by Mr. Amend, Baker & Taylor had no legal right to use this check before the date given on the check and certainly by that time Mr. Bulls had conferred with Mr. Amend and knew that Baker & Taylor should be receiving checks from Tri-State for the account of the Section 2 well, and it was after all the checks had been received that Mr. Bulls, by his statement to Mr. Amend, caused Mr. Amend to believe that the drilling costs of Section 2 well had been paid in full. In any event, any direction

or indication as to where this check should be used could be made at or about December 17th.

When this matter was first heard by this Honorable Court, Baker & Taylor's excuse for the application of these funds to the old account of Tri-State was because the costs for the drilling of Section 2 well was not yet due. They knew enough then to apply the balance from the last check ($9,963.37) to the Amend account, although the check was from Tri-State.

Their most recent explanation, when the record showed that their books were confused as to the account numbers of Mr. Amend and Tri-State, was that they considered the two accounts interchangeable.

BULLS' TESTIMONY SUPPORTS AMEND'S TO THE EFFECT THAT HE CALLED AMEND AND ADVISED HIM OF THE RECEIPT OF THREE CHECKS OF $20,000.00 EACH DURING THE MONTH OF DECEMBER, 1962 AND WHILE THE SECTION 2 WELL WAS BEING DRILLED.

Bulls says it was agreed between him and Amend that if either received money from Tri-State they would call the other and advise. (Tr. P. 73, L. 21)

Bulls made one trip to Amend's office before the drilling of the Wilbanks well in an effort to get money on the Nusbaum well. (Tr. P. 74, L. 22 to L. 3, P. 75) Later, Bulls got two $5,000.00 checks from Amend to apply on the Nusbaum well. (Tr. P. 83, L. 11)

> "I think on two occasions checks were received in our office and I called J. D. and told him the checks had been received." (Tr. P. 77, L. 21)

These conversations were by phone. (Tr. P. 78, L. 5) Mr. Amend brought one check for $20,000.00 to the office. These calls were per agreement. (Tr. P. 79, L. 3)

> "I remember, I think calling him on a second check that we received in the mail." (Tr. P. 80, L. 2-3) Bowie told him that the checks were in (Tr. P. 80, L. 14)

Bulls never at any time knew how much money was owing on the Nusbaum well, (Tr. P. 86, L. 6) although after going to Mr. Amend's office before the drilling of the Wilbanks well in December, 1962, he did receive from Amend two $5,000.00 checks on the Nusbaum well. (Tr. P. 83, L. 11)

AMEND UNDER HIS AGREEMENT WITH TRI-STATE TO PAY THIS DRILLING COST FOR AN INTEREST IN THE WELL, HAD A RIGHT TO DIRECT THE PAYMENT OF THE DRILLING COSTS OF THE SECTION 2 WELL WITH TRI-STATE'S CHECKS.

The above is plain from the circumstances of the case. Tri-State or none of its officers were present in Texas and one check for $20,000.00 was mailed to J. D. Amend, who had agreed to sell Tri-State an interest in this well if Tri-State paid the drilling and certain other costs. Although the other two checks were mailed directly to Baker & Taylor, it was at Amend's direction, and it was clear by the amounts of the checks and all the surrounding circumstances the intent of both Tri-State and Amend, and the fact that Baker & Taylor applied the balance of the last $20,000.00 check of Tri-State in payment of a debt of J. D. Amend, shows

that they, too, knew that Tri-State had agreed to pay for the account of Amend the drilling cost on the Wilbanks well. Otherwise, Baker & Taylor would never have applied Tri-State's money to the payment of Amend's debt.

Baker & Taylor's argument in relation to the check which it received and deposited on December 13th, if valid, would not be helpful in support of its contention as to the application of $10,036.63 of the last $20,000.00 check.

At the same time that Baker & Taylor gave Tri-State credit for $10,036.63 on the last $20,000.00 check, it gave J. D. Amend credit for the balance of this check. This alone shows that Baker & Taylor had knowledge that this entire $20,000.00 check was intended for application on the J. D. Amend account, and the Special Master, in effect, so found.

J. D. AMEND DID HAVE A RIGHT TO DIRECT THE APPLICATION OF THE THREE $20,000.00 CHECKS ISSUED BY TRI-STATE.

These three $20,000.00 checks issued by Tri-State Petroleum, Inc., in favor of Baker & Taylor Co. were given to pay an obligation of J. D. Amend, in consideration for which Tri-State was to receive a three-fourths interest in the gas well and lease on Section 2. Since this was a consideration given to Amend for the interest in the gas well and lease, he had the right to direct where the payment should be applied. Since Amend did not know of any indebtedness due Baker & Taylor from Tri-State and Roy Bulls also says he knew of none, they, therefore, could have had under consideration only one obligation upon which to apply

Tri-State's money, and that was the obligation for the drilling of the well on Section 2.

Bulls testified that in the drilling of each of the three wells his dealings and contact were with J. D. Amend; that J. D. Amend looked after the drilling of the well on Section 54 where Tri-State signed the contract.

From this evidence, it appears that J. D. Amend, at times, acted in the capactiy of agent for Tri-State.

ELEMENTS OF ESTOPPEL

Counsel's statement as to the essential elements of estoppel at Page 40 of his brief, which we assume is based upon the law of the State of Tesas, seems to coincide with the California law upon this subject.

Section 1962, Subdivision 3 of the Code of Civil Procedure provides:

> "Whenever a party has, by his own declaration, act, or omission, intentionally and deliberately led another to believe a particular thing true, and to act upon such belief, he cannot, in any litigation arising out of such declaration, act, or omission, be permitted to falsify it;"

In defining estoppel in pais, 18 Cal. Jur. 2d, P. 404, ¶2, says:

> "Estoppel in pais has been defined as a right arising from an act, admission, or conduct which has induced a change of position in accordance with the real or apparent intention of the party against whom the estoppel is asserted. Again, it has been said that estoppel may be defined as a bar by which a person is precluded from denying a fact in con-

sequence of his own previous action which has led another to so conduct himself that if the truth is established the other will suffer. The doctrine of estoppel in pais is well stated in Code of Civil Procedure §1962 subdivision 3, which embraces in its definition of estoppel all the necessary elements. The section provides that when a party, by his own declaration, act, or omission, has intentionally and deliberately led another to believe a particular thing to be true and to act on such belief, he cannot, in any litigation arising out of such declaration, act, or omission, be permitted to falsify it."

And in defining the elements of equitable estoppel or estoppel in pais 18 Cal. Jur. 2d P. 406, ¶5, says:

"Among the essentials of equitable estoppel or estoppel in pais are the requirements that there must have been a false representation or a concealment of material facts of the matter as to which estoppel is claimed and that the party to whom the representation was made or from whom the facts were concealed must have been ignorant, actually and permissibly, of the truth. More broadly stated, the essential elements of estoppel are false statements or concealments, or conduct amounting thereto, with reference to the transaction, made by one who has actual or virtual knowledge of the facts to another who is ignorant of the truth, with the intention, resulting in consummation, that the other should act on such false statements or concealments, or equivalent conduct. In other words, four things are essential to the application of the doctrine: (1) the party to be estopped must know the facts; (2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel

has a right to believe it is so intended; (3) the latter must be ignorant of the true facts; and (4) he must rely on the former's conduct to his injury."

18 Cal. Jur. 2d, P. 409, ¶10, says:

"A person whose representation or conduct is the basis of a claimed estoppel must have intended that others should act on that representation or conduct, or he must have spoken or acted under such circumstances that others had the right to believe he so intended. While it is often said that the principle of estoppel is invoked to prevent fraud, or that which is tantamount thereto, designed fraud, or actual fraud in a technical sense, is not essential. All that is meant by the expression that an estoppel must possess an element of fraud is that the circumstances and conduct involved would render it fraudulent for a person to deny what he previously induced or suffered another to believe and take action on, no precedent corrupt motive or evil design being necessary."

And 18 Cal. Jur. 2d P. 410, ¶11 says:

"Negligence — that is, careless and culpable conduct — is, as a matter of law, equivalent to an intent to deceive and will satisfy the element of fraud necessary to an estoppel. When a person relies on negligence as the basis of estoppel, he must show that the negligence was the proximate cause of the deceit."

Insofar as we have examined the state law of Texas upon the question of estoppel, we have found little, if any, difference from the California law upon the subject.

THE FACTS OF THE CASE

First: J. D. Amend advised Roy Bulls, the secretary of Baker & Taylor, that Tri-State had agreed to pay the drilling cost on Section 2 for an interest in the well and at the same time, handed Roy Bulls a check issued by Tri-State payable to Baker & Taylor Drilling Co. in the sum of $20,000.00, which was designated for payment on Section 2 well. Mr. Amend at the time told Mr. Bulls that if Tri-State failed to make these payments, that he wanted to be advised, for he could not afford to carry this interest and he had others to whom he could sell same. Mr. Bulls promised to so notify Amend, and in a few days he did notify Amend that the other two $20,000.00 checks had been received, which in every day language is the equivalent of saying that the drilling costs had been paid.

Mr. Amend had instructed Tri-State to send this money for this purpose and the President of Tri-State testified that the three checks were so intended.

Acting upon Mr. Bulls' statement and relying upon the fact that the drilling costs on Section 2 had been paid, Amend made no further effort to sell or dispose of this interest in the well. According to Baker & Taylor's own admission, it mailed no statements of a balance due to either Tri-State or to Amend, and each had a right to assume and they believed that the entire drilling costs on this Section 2 well had been paid, and to the detriment of both Amend and Tri-State.

It works an injustice to Mr. Amend because the money which Mr. Amend was led to believe had been received for the drilling cost on Section 2 was applied for a different purpose. Mr. Amend therefore had no

opportunity to negotiate with another purchaser for this interest or to insist upon Tri-State correcting the situation.

This worked an injustice upon Tri-State because the lien imposed upon the gas well on Section 2 prevented Tri-State from raising the necessary funds to extinguish this lien and get the well on production. If Baker & Taylor had filed a lien upon Section 54 where the Tri-State indebtedness arose, the gas well on Section 2 would have been in operation long ago because an agreement could have been reached with the other creditors to impound the funds.

GENERAL ORDER 47 PROVIDES IN PART THAT: "A SPECIAL MASTER SHALL SET FORTH HIS FINDINGS OF FACT AND CONCLUSIONS OF LAW, AND THE JUDGE SHALL ACCEPT HIS FINDINGS OF FACT UNLESS CLEARLY ERRONEOUS."

The Courts have repeatedly held that they are bound to accept the findings of a Special Master or a Referee unless *clearly erroneous.* A few of the more recent cases in support of this view, which cite other cases, are:

Simon v. Agar, 299 F. 2d 853, which says:

> "It is too well settled to require the citation of authorities that where an appeal brings up for review concurrent findings of fact by the referee and the district court, they can be set aside only if 'clearly erroneous.' See Bankruptcy General Order 47, 11 U.S.C.A. following section 53; Rule 52(a) F.R.Civ.P., 28 U.S.C.A. Particularly is this true where, as in this case, the findings involve questions of credibility of witnesses who testified before the

referee. See *Morris Plan Industrial Bank v. Henderson,* 2 Cir., 131 F.2d 975, 977; *Margolis v. Nazareth Fair Grounds & Farmers Market, Inc.,* 2 Cir., 249 F. 2d 221, 223; *Smith v. United States,* 5 Cir., 287 F. 2d 299, 301. Appellant has not carried his burden of convincing us that both essential findings are clearly erroneous."

Washington v. Houston Lumber Company, 310 F. 2d 881 at 882, says:

"The fact findings of the Refere are binding, both on the district court and on this court, unless clearly erroneous."

In re Berger Steel Company, Inc., 327 F. 2d 401 at 405, says:

"However, whatever impressions we may now derive from our study of the printed record, the Referee saw and heard these witnesses. It is axiomatic that issues of credibility are for the triers of the facts. The findings of fact made by the Referee and by the District Court are entitled to great weight on review. General Orders in Bankruptcy, Nos. 36 and 47; *In re United Wholesalers, Inc.,* 7 Cir., 1960, 274 F. 2d 316, 319; *In re Pringle Engineering & Mfg. Co.,* 7 Cir., 1947, 164 F. 2d 299, 301."

See also:

Solomon v. Northwestern State Bank, 327 F. 2d 720 at 724.

Because of this rule of law, the argument of Baker & Taylor upon the effect of the evidence would have been more appropriate before the trier of the facts who saw

and heard the witnesses and was in a better position to judge the true situation. We made our argument upon these questions before the Special Master and prevailed.

The Special Master not only saw and heard the witnesses, but also took into consideration all the surrounding circumstances and inferences which could reasonably be drawn from the evidence.

The Special Master had before him the law as expressed in 44 Texas Jurisprudence P. 687, and in *Bray v. Crain,* 59 Texas 649, which in effect holds, with reference to the direction of payments upon accounts, that there need not be an expressed agreement, but a tacit understanding of the parties is sufficient, and that their real understanding, however manifested or ascertained is controlling, and that such questions are for the trier of the facts, and may be implied from the circumstances.

APPENDIX NO. 6.

Additional cases upon the question of jurisdiction are the following:

Warder v. Brady, 115 F. 2d 89, at 94, ¶9, which says:

> "It seems clear that the bankruptcy court under Chapter X has jurisdiction to entertain all suits to which its trustee or the debtor in possession is a party, even though they be instituted against adverse claimants."

Where a party to a summary proceeding in a bankruptcy court has the right to object, such right may be waived by consent.

> *MacDonald v. Plymouth County Trust Company,* 286 U. S. 263, 52 S.Ct. 505.

"The fact that the petition did not seek an adjudication but a reorganization in no wise limited the court's jurisdiction of the subject matter and its right to proceed summarily against all but adverse claimants, which attached upon the filing of the petition and its approval."

> *In Re Park Beach Hotel Bldg. Corp.,* 96 F. 2d 886 at 891, ¶(6-7).

The above case is also authority for the Bankruptcy Court's paramount and exclusive jurisdiction, which cannot be affected by proceedings in other courts, whether state or federal. See ¶(1-4), P. 891.

See the case of *Detroit Trust Co. et al. v. Campbell Bell River Timber Co. Ltd., et al.,* 98 F. 2d 389 (9th

CC), where some of the property involved was in British Columbia.

As to the power of the bankruptcy court in Chapter X proceedings over property claimed by the bankrupt, see:

In Re Standard Gas & Electric Co., 119 F.2d 658 at 661, where the Court cites and quotes from the case of *Taubel-Scott-Kitzmiller Company, Inc. v. Fox,* 264 U.S. 426, 44 S.Ct. 396, 68 L.Ed. 770.

No. 20071

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BAKER & TAYLOR DRILLING CO.,

Appellant,

vs.

R. W. STAFFORD, Trustee,

Appellee.

APPELLANT'S REPLY BRIEF.

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R. W. STAFFORD, Trustee,

Appellee.

APPELLANT'S REPLY BRIEF.

Statement Re Order of District Court Referring Proceeding to Referee and Special Master.

Appellee's brief states that appellee does not find in the Record the Order of the Judge of September 4, 1963, referring the proceeding involved to Ronald Walker as Referee and Special Master. While copy of the Record, as originally prepared, to which appellant had access, did not reflect that Order, the Record was subsequently supplemented and that Order is in the Record at page 296 of the Transcript of Record. Appellant joins appellee in referring to that Order and joins appellee in stating that by Order of September 4, 1963, the United States District Court for the Southern District of California, Central Division, through Judge W. C. Mathis, District Judge, appointed Ronald Walker as Referee and Special Master.

Appellant takes issue with the second grammatical paragraph, page 3 of appellee's brief, and with the Record reference by appellee referred to as supporting that statement.

Statement of Appellant Taking Issue With Appellee as to Factual Matters.

Appellant takes issue with the last grammatical paragraph, page 3 of appellee's brief, and with the Record reference by appellee refered to as supporting that statement.

Appellant takes issue with the last grammatical paragraph, page 3 continuing on to page 4 of appellee's brief, and the record reference as referred to in support of that paragraph. Appellant further takes issue with appellee's interpretation in that paragraph of what appellee states briefly to be the agreement between J. D. Amend and the debtor corporation. If it be appellee's interpretation of the letter of February 11, 1963, to H. F. Schlittler, the letter certainly does not support or justify such an interpretation. Appellee refers to that letter as record reference for the agreement. The letter does not purport to be an agreement or even a proposal to the debtor corporation, and in any event makes no reference to $60,000.00. The letter is set out in full as Appendix Exhibit 7 to appellant's brief. The letter appears as Exhibit 3 to Amend's Deposition and was introduced and received in evidence. [Tr. p. 3, March 24 hearing.]

Appellant takes issue with appellee's statement in the last paragraph on page 4 of his brief that the drilling costs of the well on Section 56 were paid and advanced by the debtor corporation as being unsupported by the

Record. Baker & Taylor Exhibit "C" reflects a check of Baker & Taylor Drilling Co. for $9,000.00 signed "J. D. Amend Escrow Account, payment on Section 56." At page 38 of the Transcript of March 24 hearing J. D. Amend testified that the check was his check. Amend further testified at page 39 of the Transcript that the checks, other than the $11,000.00 check which went to pay for the well on Section 56, were checks by him.

Appellant takes issue with appellee's statement on pae 5 of appellee's brief that "on August 24, 1962, and pursuant to oral agreement between J. D. Amend and the debtor corporation" the debtor corporation at this time entered into a contract for the drilling of an oil and gas well with Baker & Taylor Drilling Co. upon Section 54. We do not take issue with, but declare that Tri-State Petroleum, Inc. did on August 24, 1962, enter into a contract with Baker & Taylor Drilling Co. for the drilling of a well on Section 54, but challenge the statement that it was pursuant to the original agreement between J. D. Amend and the debtor corporation. Appellee makes record reference to page 10, line 16, of the March 24 hearing. The Record at that place does not support the statement and we do not find in the Record at any place evidence to support the statement.

While probably only a typographical error, appellee at page 7 states that the well on Section 2 was to be drilled "to a depth of 5400 feet from the surface." 800 feet was the depth specified in the contract and not 5400 feet. [See Contract, Defendant's Exhibit 1, Amend Deposition.]

At page 7 of appellee's brief appellee states that the contract for the drilling of the well on Section 2 provided that the sum shall be "payable in 30 days" after completion of the drilling of the well. The contract provides for payment "within Thirty (30) days." [See Contract, Defendant's Exhibit 1, Amend Deposition.]

Appellee's statement with respect to the three $20,000.00 checks, the application of which is here involved, is completely misleading, completely disregards the dates of receipt by Baker & Taylor Drilling Co. of the checks and disregards the fact that the checks were not received by appellant in date order. The check dated December 15 is identified and frequently referred to as Check No. 142. That check is the $20,000.00 check which was received by Baker & Taylor Drilling Co. from J. D. Amend, receipted for him but receipted as of date December 19, 1962, and was deposited by appellant on December 20, 1962. The receipt is Deposition Exhibit 12 to Amend Deposition. See also Baker & Taylor Exhibit "L" which is Appendix Exhibit 6 to appellant's brief.

While J. D. Amend never testified positively that December 19, 1962, the date of receipt by him, was the exact date on which he delivered Check No. 142 to Baker & Taylor Drilling Co., he testified that that was the approximate date:

> "Q. Now, Mr. Amend, do you know or could you determine the date at which you delivered to Baker & Taylor the check No. 00142? A. Wasn't there an exhibit that had that date on the—
>
> Q. There is a receipt, deposition Exhibit No. 12, which— A. Well, that would be the approximate date of it.

Q. December 19, 1962? A. Yes.
Mr. Utley: That delivery was what date?
Mr. Berry: December 19, 1962." [Tr. p. 53, March 24-25 hearing.]

Check No. 142 was the only check delivered to Baker & Taylor by Amend. The receipt which Amend received and accepted was dated December 19, 1962, and states "Received of J. D. Amend this 19th day of December, 1962." [See Receipt in full Appendix Exhibit 12 of appellant's brief.]

It is uncontrovertibly established that Check No. 127 in the amount of $20,000.00, dated December 17, 1962, was received, deposited and credited to the Tri-State account on account of the Nusbaum Well, on December 13, 1962. [See Baker & Taylor Exhibit K which is Appendix Exhibit 5 to appellant's brief.] It was not paid by the drawee bank until December 18, 1962. [Tr. p. 18, March 24 hearing; Tr. pp. 18, 11, 112, and the check itself, Trustee's Exhibit 7.] The check was drawn on the Greenfield State Bank of Bakersfield, California, and was deposited in The First National Bank of Amarillo, Texas. [Baker & Taylor Exhibit E, Tr. p. 13, March 24 hearing.] The entire Record reflects that the time at which J. D. Amend claims to have had his conversation with Roy Bulls, in which he claims that he told Bulls that Tri-State Petroleum, Inc. had agreed to pay the drilling costs for the well on Section 2, and claims he told Bulls at the time that he did not want to carry a further interest in the well and that Bulls then and there told Amend that he would notify him as to whether or not his company received further payment, *occurred* at the time the one and only check delivered by Amend to appellant was delivered.

Appellee in his brief at page 9 states that notwithstanding the conversation between J. D. Amend and Roy Bulls and Mr. Bull's telephone call back to Amend that the drilling costs on the well had been paid, Baker & Taylor Drilling Co. proceeded to apply all of the check dated December 17, 1962, to the balance due and payable by Tri-State Petroleum, Inc. for the drilling of the well on Section 54. Such statement and position by appellee is incorrect and grossly misleading because it is uncontrovertible that the check of December 17, 1962, was credited before the conversation between Amend and Bulls, whatever it was, took place, and before any telephone calls from Bulls to Amend, whatever they were, occurred.

Appellant takes issue with the statement in appellee's brief that dispute arises over the fact that it (appellant) applied funds mailed to it for payment of the drilling costs on Section 2 to the balance due it by Tri-State Petroleum, Inc. for drilling work on Section 54. H. F. Schlittler was the only man connected with Tri-State Petroleum, Inc. who testified at the hearings, and his testimony is:

> "Q. Mr. Schlittler, you said the obligation for drilling the Section 2 well was Tri-State's obligation. I take it by that you mean it was Tri-State's obligation to J. D. Amend? A. In agreement with Mr. Amend, that is right.
>
> Q. And it had nothing to do with the obligation as between J. D. Amend and Baker & Taylor Drilling Company? A. Well, no. As far as I am concerned, no." [Tr. p. 167, March 24-25 hearing.]
>
> * * * * *

"Q. You never directed anything to Baker & Taylor Drilling Company with respect to the application of payments, I take it? A. No, sir." [Tr. pp. 167-168, March 24-25 hearing.]

Appellee states in his brief that Bulls, Secretary of Baker & Taylor, was informed by J. D. Amend that Tri-State had promised to send this money (referring to the $20,000.00 check) for this particular purpose and requested that he be informed when it arrived and Mr. Bulls did inform Mr. Amend that it had been received. This statement is challenged as not being supported by the Record. A reading of appellee's brief in the first grammatical paragraph ending on page 14 thereof might lead one to conclude that appellee is referring to Amend's testimony as set out in appellant's Exhibit 10 as supporting such statement. Such Exhibit 10 does not support such statement.

At page 14 of appellee's brief is, the possible misleading, statement that the three $20,000.00 checks were identified or mailed for the purpose of application on the Amend debt owing to appellant. Mr. Schlittler did not so testify and neither did anyone else so testify. Only check No. 142 had any designation of how it was to be applied. The Record is replete of testimony that the other two checks had no designation for application and that nobody designated their application. Schlittler testified that he did not have anything to do with the mailing of the checks. [Tr. p. 163, March 24 hearing.]

Appellant challenges appellee's statement that Mr. Bulls of Baker & Taylor was informed by Amend that the $20,000.00 checks were mailed for the purpose

of application on Amend's debt, and accepted Tri-State as a proper person to pay the obligation of J. D. Amend. Such is not supported by the Record. Neither the testimony of Bulls nor Amend supports such a statement.

While appellee states at page 13 of his brief that Baker & Taylor is nothing more than lien claimant against property admittedly owned by the debtor and J. D. Amend is, of course, incorrect. Appellant does not admit that any property is owned by the debtor. Aside from that erroneous statement, however, such statement by appellee completely disregards the fact that Baker & Taylor Drilling Co. holds and asserts a contractual personal debt liability of J. D. Amend which the Special Master sought to enjoin it from enforcing.

While appellee chooses to designate the relationship of J. D. Amend and Tri-State Petroleum, Inc. with respect to the property involved as joint venturers, no part of the Record in this case justifies or supports any such relationship. The letter from Amend to Schlittler, which Amend and Schlittler say represents their understanding, does not justify such a conclusion. The letter simply evidences an agreement to make an assignment of ¾ interest in the well in question upon various conditions, which were never performed.

Had such assignment been made, the relationship would have been that of cotenants. (See 42 Tex. Jur. 2d, Sec. 20, pp. 51-53.) A copy of the text is included herein as Exhibit 1 for ready reference. See also discussion notes 4 Oil and Gas Reporter 892 (1955).

In Re Lack of Jurisdiction by Bankruptcy Court and Special Master.

While the Transcript of evidence does not reflect that the Trustee's report of August 9, 1963, which lists 66% of the leasehold estate and well involved as owned by others than the debtor, was introduced in evidence before the Special Master, same is nevertheless a part of the Record in the proceeding. Same is nevertheless a part of the Record before this Court and is reflected at pages 25 to 90 of the Transcript of Record. The listing of the interests is reflected at page 51, Transcript of Record. Without becoming involved in protracted argument as to the effect of that report or the effect of *Woods v. Deck,* 112 F. 2d 739 (cited by appellee), it is certainly unquestioned and is uncontrovertible that J. D. Amend owned and owns, at least, a 25% undivided interest of the lease and the well in question, which 25% undivided interest was never in any regard committed to the debtor. The debtor had and has no rights, claim or interest thereto and never asserted any claim, interest or right thereto.

While it is recognized that the Special Master purported to find, in Finding of Fact No. II, that among the properties in which the debtor corporation has an interest are the well and lease in question [Tr. p. 167], the Special Master never purported to find or determine what that interest is. Among the various other reasons for lack of jurisdiction of the subject matter by the Special Master and the Court below one completely unanswerable is that there is at least and in any event a 25% undivided interest in the property which belonged and belongs to J. D. Amend, which 25% undivided interest the Trustee or the bankrupt

never had any right or claim and never asserted any right or claim. There is also involved the personal obligation of J. D. Amend to Baker & Taylor as established by the contract and as established by the testimony of J. D. Amend. [Tr. p. 14, lines 1-20, March 24 hearing.] Nevertheless the Special Master, and ultimately the District Court through approval of the Special Master's Order, purports to assume jurisdiction of the entire property and purports to enjoin and restrain Baker & Taylor Drilling Co. "from hereafter filing, prosecuting or taking any action in any court of any jurisdiction, other than before this court, against *J. D. Amend* or Tri-State Petroleum, Inc. or the Trustee in Bankruptcy of Tri-State Petroleum, Inc., debtor, based upon its claim growing out of the drilling of the gas well mentioned and described in these proceedings."

Appellant earnestly urges all the aspects of lack of jurisdiction of the Bankruptcy court and the Special Master as presented in its Specifications of Error and the authorities as presented in its opening brief, and that the Bankruptcy Court and the Special Master were wholly without jurisdiction of the subject matter with respect to which they sought to act and of the person and rights of appellant. Appellant further earnestly urges that under no conceivable theory or reasoning could the Bankruptcy Court or the Special Master have any jurisdiction of the 25% undivided interest of J. D. Amend in the lease and well in question or of the personal rights and liabilities between J. D. Amend and appellant. Appellee cites no statutes so providing or authority so holding. Appellant submits that no such jurisdiction existed or exists. The Special Master and Bankruptcy Court in these regards,

in any event, have purported to act beyond any conceivable jurisdiction or authority and have so purported to dispose of substantial rights of appellant.

Appellee urges and has urged that the Bankruptcy Court had summary jurisdiction because it urges that J. D. Amend had consented to the summary jurisdiction.

While it is recognized that J. D. Amend probably submitted his person to the jurisdiction of the Bankruptcy Court, try as one may to find such, he never in any regard submitted or purported to submit his uncontrovertibly owned 25% undivided interest of the property involved to the jurisdiction of the court. In law and in fact he could not do so. As is said in Collier on Bankruptcy, 14th Ed., Vol. 6, Sec. 305, p. 576, and *In re Prima Co.*, 98 F. 2d 952 (7th Cir. 1938) courts of bankruptcy possess only such jurisdiction and powers as are expressly or impliedly conferred on them by Congress. To say that J. D. Amend could submit his property to the jurisdiction of the bankruptcy court and thereby confer on the Bankruptcy court jurisdiction as to Baker & Taylor Drilling Co. with respect to such property and jurisdiction of Baker & Taylor Drilling Co. as to personal obligations and rights as between Baker & Taylor Drilling Co. and J. D. Amend is completely beyond the pale of any authority. Bankruptcy courts have jurisdiction to administer only property of bankrupts and have no jurisdiction to administer property of third parties or to grant protection to third parties.

Appellee's position and argument completely disregards the United States Supreme Court decisions in *Taubel-Scott-Kitzmiller Co. v. Fox,* 264 U.S. 426,

68 L. Ed. 770, and *Cline v. Kaplan,* 323 U.S. 97, 89 L. Ed. 99 (1954), as well as the other cases cited in appellant's brief under argument with respect to lack of jurisdiction of the subject matter of the person of Baker & Taylor Drilling Co. In *Cline v. Kaplan* the Supreme Court stated with respect to such matters:

> "Once it is established that the claim is not colorable nor frivolous, the claimant has the right to have the merits of his claim passed on in a plenary suit and not summarily."

Viewing the uncontrovertible facts as presented by the Record and as set out under Statement of Facts in appellant's brief, and even considering appellee's brief, it cannot reasonably be concluded that Baker & Taylor's claim is frivolous or colorable only.

Appellee's argument under "Exclusive Jurisdiction of the Debtor and its Property Wherever Located" and the authorities therein cited in no regard meet the situation here involved. The Special Master, with ultimate approval of the District Court, has not merely sought to deal with property of the bankrupt and to pass upon the amount of validity of claims against the bankrupt, but has sought summarily to adjudicate an interest or title into the bankrupt as against a bona fide substantial and strong claim of Baker & Taylor Drilling Co. that no such title exists, and has sought to exercise a jurisdiction with respect to property in which unquestionably and uncontrovertibly the bankrupt has no interest or title and has sought to adjudicate rights and liabilities between Baker & Taylor Drilling Co. and J. D. Amend as to personal liabilities and obligations between them and has enjoined the pursuit of

those rights of Baker & Taylor Drilling Co. against J. D. Amend.

Appellee and the Special Master have wholly failed to make the inescapable distinction that Amend owned a property right and interest in which the creditor uncontrovertibly had no right, title or interest and that Amend had a personal and individual obligation and liability to Baker & Taylor Drilling Co. under his contract which in no manner or regard affected or could affect the bankrupt creditor.

At the time of the contract between Baker & Taylor Drilling Co. and Amend the bankrupt creditor was not remotely involved. The debt to Baker & Taylor Drilling Co. by J. D. Amend is a matter between Amend and Baker & Taylor. Appellee's statement that the entire transaction out of which Baker & Taylor's claimed indebtedness arose was a three-party transaction in which Tri-State was a party is wholly and completely unsupported by the Record. The Record establishes the opposite.

The argument by appellee that the filing of a lien by Baker & Taylor Drilling Co. changed the situation so as to subject Baker & Taylor to the jurisdiction of the court is wholly fallacious, such argument simply assumes jurisdiction to exist. Appellee's argument that it is necessary to protect J. D. Amend from his personal contract obligations and suits to enforce same and to protect his property in order to protect the bankrupt creditor is erroneous in fact and in law.

The argument of the Trustee that a proceeding by appellant against J. D. Amend with respect to personal obligations of J. D. Amend to appellant would so affect the bankrupt creditors' rights as to vest the Bankruptcy

Court with jurisdiction to enjoin such action has been repudiated in *In re Magnus Harmonica Corp.*, 233 F. 2d 803 (3rd Cir. 1956); *In re Magnus Harmonica Corp.*, 237 F. 2d 867 (3rd Cir. 1956); and *In re Diversey Bldg. Corp.*, 86 F. 2d 456 (7th Cir. 1936) (cert. den. in *Diversey Building Corporation v. Weber*, 81 L. Ed. 870, 300 U.S. 662, 57 S. Ct. 492).

The question of whether Amend's interest in the property is subject to a lien of appellant is of no concern to the bankrupt creditor or the Bankruptcy Court. The bankrupt creditor has no right in J. D. Amend's property and whether his interest be subject to lien or not cannot affect the bankrupt creditor or its estate. In any event that the determination of that question is beyond the pale of the Bankruptcy Court is established by authorities cited in appellant's opening brief.

Without receding in any regard from any of its other positions, appellant says that a different situation might have been presented if the Bankruptcy Court had merely held that the bankrupt creditor had or was entitled to a ¾ interest in the property involved and that Baker & Taylor Drilling Co. might not proceed against that ¾ interest, or to pursue a claim against that ¾ interest. Appellant earnestly urges that those questions themselves could not be adjudicated by the Bankruptcy Court, but were required to be determined in a plenary proceeding in a court which could acquire jurisdiction over Baker & Taylor Drilling Co. and the subject matter. In any event, however, the bankruptcy court did not stop at any such point, but proceeded to attempt to completely dispose of appellant's rights with respect to property over which the Bankruptcy Court

could not conceivably have jurisdiction, *i.e.* at least the 25% undivided interest of J. D. Amend, and to dispose of and adjudicate rights as between two third parties and to exercise jurisdiction over rights and parties of which and of whom the Bankruptcy Court had no jurisdiction.

In Re Estoppel.

Appellant, as it has at all times, urges that this case should be disposed of on the grounds of lack of jurisdiction. It nevertheless urges that if the question is reached the lien or debt of appellant is established.

Appellee belabors the question of whether J. D. Amend had the right to direct where the payments of Tri-State should be applied. Appellee also propounds the theory that J. D. Amend at times acted in the capacity of agent for Tri-State. Appellant challenges the existence of proof of any such. Each of such arguments by appellee is wholly academic in that the positive and uncontradicted and uncontrovertible evidence is that J. D. Amend did not at any time direct Baker & Taylor Drilling Co. as to any application of payments. At the expense of being repetitious, we reiterate:

J. D. Amend testified time and again that he did not direct Baker & Taylor Drilling Co. as to any application or as to how any check was to be applied [Amend Deposition 31, 32; Tr. pp. 51, 52, 53, March 24-25 hearing; Tr. p. 108, July 1-2 hearing.]

J. D. Amend testified that he had no instruction from Tri-State as to application of payments [Amend Deposition 29.]

H. F. Schlittler, President of Tri-State Petroleum, Inc., testified with respect to the issuances of the three $20,000.00 checks and was the only person connected

with Tri-State who testified, testified that he did not direct anything to Baker & Taylor Drilling Co. with respect to application of payments [R. pp. 167, 168; Tr., March 24 hearing.]

Certainly the testimony of Amend, Schlittler, Bowie and Bulls all negative any direction to appellant as to application of the two checks in question. The Special Master did not find that there was any direction to Baker & Taylor Drilling Co. as to application of payments. Appellee falls back on estoppel of Baker & Taylor Drilling Co. Appellee's position as to what Baker & Taylor Drilling Co. is estopped from has always been quite nebulous and is left so in appellee's brief. Search as one may through all the testimony and all the Record, there is no semblance of evidence that Bulls or anyone else informed Amend, Tri-State or anyone else as to anything more than that a certain sum of money, *i.e.* a third check from Tri-State Petroleum, Inc. in the sum of $20,000.00, or a total of $60,000.00, had been received.

The Special Master by his Finding of Fact VIII found that Baker & Taylor Drilling Co. is estopped from asserting a claim against J. D. Amend or Tri-State Petroleum, Inc., or from asserting a lien against the gas well or leasehold interest on Section 2, above described, in any sum whatsoever; and that the leasehold interests in gas well on Section 2 are free from any interest or claims of appellant in any sum whatsoever. By the Special Master's Conclusion of Law III he concludes that the claim and defense of estoppel asserted by the Trustee and J. D. Amend against the claim of Baker & Taylor Drilling Co. are true and sufficient to "sustain the plea of estoppel" and does

estop Baker & Taylor Drilling Co. from applying the funds received by Baker & Taylor Drilling Co. in December, 1962, upon the balance due it from Tri-State Petroleum, Inc. for the drilling of a well on Section 54, known as the Nusbaum Well. Any finding or conclusion by the Special Master that Baker & Taylor Drilling Co. was informed and knew that the two $20,000.00 checks in question were mailed by Tri-State for the purpose of paying the drilling costs on the Wilbanks well is completely contrary to the testimony of Amend and Schlittler. It is to the testimony of those two only that the Special Master could look for support of any such finding or conclusion. Such finding or conclusion is clearly wrong, and is not within the permissible range of any evidence.

It is respectfully submitted and earnestly urged that there was no direction as to application of payment, there was no representation by Baker & Taylor Drilling Co. as to any manner or mode of payment, and that by whatever rule of estoppel this case is to be measured, indispensable elements of estoppel are absent.

There is wholly absent any false representation or concealment of any fact by appellant.

Under the Texas rule, as to essential elements of estoppel, an essential element is that the party relying on estoppel or to whom the false representation was made must have relied on or acted on it *to his prejudice.* Under the California rule, as stated by appellee, an essential element is that the person claiming estoppel must rely on the conduct *to his injury.*

The person claiming estoppel must have done or omitted some act or changed his position in reliance on the representation and conduct of the other party. Such follows from the elements of estoppel as contained

in the authorities in appellee's brief as well as appellant's brief.

See *State of Oklahoma v. State of Texas,* 45 S. Ct. 497, 268 U.S. 252, 69 L. Ed. 937; 31 C.J.S., Sec. 72, p. 442; 22 *Tex. Jur.* 2d, Sec. 16, p. 683; and *Nance v. Currey,* 257 S.W. 2d 847 (C.C.A.). Excerpts from such authorities are included as Appendix Exhibit 2.

By whichever rule the question of estoppel is measured, that necessary element of reliance or action to injury or prejudice is completely absent. There is no evidence whatsoever and no finding by the Special Master that either Amend or the bankrupt debtor did or refrained from doing any act, nor relied on any act of Baker & Taylor to their injury or prejudice.

Any contention of estoppel is simply a contention that Trustee and Amend now have the right to have reversed the application made by Baker & Taylor Drilling Co. to Tri-State's account of Tri-State's funds received by Baker & Taylor Drilling Co. from Tri-State without direction as to application, which application was made at the time of receipt, and now have such funds credited to the account of J. D. Amend. The facts simply do not raise an estoppel which does or can effect any such gymnastics. The law simply does not permit such. See authorities cited in appellant's brief.

Wherefore, appellant prays as in its opening brief.

Respectfully submitted,

David M. Garland,
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Underwood, Wilson, Sutton,
Heare & Berry,

Attorneys for Appellant, Baker & Taylor Drilling Co.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion the foregoing brief is in full compliance with those rules.

David M. Garland.

APPENDIX EXHIBIT 1.

42 Tex Jur 2d Oil and Gas § 20

§20. *Divided interest; Cotenancy.*

The bundle of interests that constitutes ownership of a parcel of land or of the minerals therein may be divided in a number of ways. To mention only a few, two or more persons may own interests in land in a form of concurrent ownership; ownership may be divided among the owners of present possessory interests such as estate for years, life estate, or fee simple defeasible, and the owners of future interests such as remainders, reversions, or possibilities of reverter; legal ownership may be in a trustee and equitable ownership divided among owners of present and owners of future interests; ownership may be subject to restrictions imposed by reason of the minority or incapacity of the owner, or may be subject to a variety of security interests or restrictions on the use of the property; or separate parcels of land may by agreement be subject to a plan of development that may give the owner of each individual parcel some interest in the other individual parcels.[6] Thus, the owners of undivided portions of oil and gas rights in and under real estate are tenants in common, and a lessee of such a cotenant becomes a cotenant with the cotenants of his lessor.[7] The relationship between co-lessors under a unitized lease has been described as a joint ownership or joint tenancy in all the royalties reserved in the lease, so that all the lessors are necessary and indispensable parties to an action of trespass to try title to one of the tracts covered by the lease,[8] and production on any tract covered by the unitized lease is regarded for all purposes as produc-

tion from all the tracts, so as to perpetuate beyond the primary term a mineral deed to one tract for a term of years and so long thereafter as oil, gas, or minerals shall be produced, though no production has been obtained from that particular tract.[9] This relationship has also been described in terms of mutual conveyances by the co-lessors of undivided interests in the minerals under their respective tracts.[10] Again, a tenancy in common in an oil and gas leasehold may arise through a single lease to multiply lessees, an assignment of undivided interests by a single lessee, or leases by tenants in common to different lessees.[11] Thus, where cotenants in a tract of land execute leases to different lessees of the undivided interests of the respective cotenants in the entire tract, that transaction of itself constitutes these lessees cotenants in the leasehold, so that one lessee is entitled to share in the profits from production obtained on the tract by another lessee, even though the first lessee does not obtain production or attempt to do so.[12] And where the lessees enter into a joint operation agreement, the agreement does more than merely embody the law of cotenancy, and under it production by one lessee is production by the other for all purposes, and will satisfy the habendum clause in the lease of the other calling for continued production on the tract by the lessee in order to extend the lease beyond the primary term.[13] But it has been held that the ownership of a mineral estate in the whole of a voluntary subdivision and of a mineral lease in a portion thereof did not involve merger or make the owner-lessee a tenant in common with the remaining portion of the subdivision, or liable to the other lessee for any part of the oil and gas produced under a drilling permit.[14]

APPENDIX EXHIBIT 2.

Excerpts From Authorities With Respect to Elements of Estoppel.

State of Oklahoma v. State of Texas, 45 S. Ct. 497, 268 U.S. 52, 69 L. Ed. 937:

"In this situation the asserted estoppel must fail. Only where conduct or statements are calculated to mislead a party, and are acted upon by him in good faith, to his prejudice, can he invoke them as a basis of such an estoppel."

31 C.J.S., Sec. 72, p. 442:

"It is essential to an equitable estoppel that the person asserting the estoppel shall have done or omitted some act or changed his position in reliance upon the representations or conduct of the person sought to be estopped. A change of position which will fulfill this element of estoppel must be actual, substantial, and justified."

22 Tex. Jur. 2d, Sec. 16, p. 683:

"Estoppel is always predicated on the conception that the pleader thereof has been misled to his prejudice by some statement, act, or conduct of another who seeks to assert a right inconsistent therewith. Thus, one material element of an estoppel is that the party claiming it must have been misled by the representations or conduct of the opposite party to change his position in such a manner that he will be injured if estoppel is not declared. No estoppel is predicable of acts or statements of the defendant where it is not shown that the conduct or position of the plaintiff has in

any respect been influenced thereby to his prejudice in some material aspect. The rule is fundamental that, unless the representation of the party to be estopped has been acted on by the other party in a way different from the way in which he otherwise would have acted, and to his prejudice, no estoppel arises."

Nance v. Currey, 257 S.W. 2d 847:

"Reliance and change of position are essential elements of estoppel. *Nelson v. Wilson,* Tex. Civ. App., 97 S.W. 2d 287; 17 Tex. Jur. 145."

No. 20,070

IN THE

United States Court of Appeals

For the Ninth Circuit

CASE-SWAYNE CO., INC., a corporation,
Appellant,

vs.

SUNKIST GROWERS, INC., a corporation,
Appellee.

APPELLANT'S OPENING BRIEF

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No. 20,070

IN THE

United States Court of Appeals

For the Ninth Circuit

'ASE-SWAYNE CO., INC., a corporation,
Appellant,

vs.

'UNKIST GROWERS, INC., a corporation,
Appellee.

APPELLANT'S OPENING BRIEF

JURISDICTION OF THE DISTRICT COURT AND THE COURT OF APPEALS

Complaint for treble damages under Section 4 of
le Clayton Act wherein the plaintiff Case-Swayne
o. alleged that Defendants Sunkist Growers, Inc.,
hereinafter referred to as Sunkist, the Exchange
range Products Co., hereinafter referred to as Ex-
change Orange, and Exchange Lemon Products Co.,
hereinafter referred to as Exchange Lemon, combined
ad entered into contracts and conspired and have
onopolized and attempted to monopolize the trade
i product oranges grown in California and Arizona
i violation of Sections 1 and 2 of the Sherman Act.

Jurisdiction of the District Court is based under Sections 1 and 2 of the Sherman Act, Act of July 2, 1890, Chapter 647, Sections 1 and 2, 26 Stat. 209, and Section 4 of the Act commonly referred to as the Clayton Act, 38 Stat. 730, Act of Oct. 15, 1914, 15 U.S.C. Secs. 1, 2, and 15, respectively (C.T. 1-2).[1]

Final judgment was entered in the matter March 2, 1965 (C.T. 2110-11). Jurisdiction of the Court of Appeals for the 9th Circuit is based on the Notice of Appeal filed March 29, 1965 (C.T. 2142) pursuant to Rule 73(a) (b) Rules of Civil Procedure for the United States District Courts.

STATEMENT OF THE CASE

I. THE PROCEEDINGS

This case is before this Court on an appeal from the District Court's judgment based on the District Court's order granting defendant's motion for a directed verdict (C.T. 2093-2104).

The proceedings relating to the questions presented on appeal are, briefly, as follows:

April 15, 1958, plaintiff filed its complaint against defendants Sunkist, Exchange Orange and Exchange Lemon, alleging they had conspired and entered into contracts to restrain trade and had monopolized and

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[1]Pages and lines in Clerk's Transcript are referred to as follows: C.T. : (line).
Pages and lines in Reporter's Transcript are referred to as follows: R.T. : (line).

ttempted to monopolize the trade in product oranges rown in California and Arizona in violation of Sections 1 and 2 of the Sherman Act (15 U.S.C. Secs. 1 nd 2), alleging damages by reason of defendant's cts in the sum of $800,000.00 and praying that damges be trebled pursuant to Section 4 of the Clayton ct, 15 U.S.C. Sec. 15 (C.T. 1-13).

July 21, 1958, defendants answered the complaint enying conduct in violation of the Sherman Act and lleging an affirmative defense that defendants were gricultural marketing associations meeting the requirements of Sec. 6 of the Clayton Act (15 U.S.C. Sec. 17) and of Sec. 1 of the Capper-Volstead Act (7 U.S.C. Sec. 291) and that the claimed violations of he antitrust laws "are exempt from the antitrust aws by said statutes." (C.T. 155-170).

On October 31, 1958, the defendants Exchange Orange and Exchange Lemon merged into Sunkist. Sunkist assumed all the obligations of the merged corporations and pursuant to motion of Sunkist the defendants Exchange Orange and Exchange Lemon were lismissed from the action (C.T. 611-12).

On June 29, 1962, pursuant to leave of Court duly obtained, plaintiff filed a supplemental complaint pleading transactions occurring since the date of the original complaint and alleging additional damages thereby from April 15, 1959, to January 31, 1962, in the sum of $1,412,000.00 (C.T. 1078-1083). Sunkist filed no answer to the supplemental complaint.

A hearing had been scheduled on March 2, 1964, relating to plaintiff's objections to certain interroga-

tories. In plaintiff's Memorandum in Reply to "Defendant's Memorandum of Points and Authorities in Support of Opposition to Plaintiff's Objections to Certain Interrogatories", filed February 26, 1964 (C.T. 1188-1194, particularly 1190:7-17), plaintiff advised defendant that it would request the Court at the hearing for leave to file a second supplemental complaint to bring matters up to date (C.T. 1190:7-17).

At the hearing of March 2, 1964, plaintiff asked leave of the Court to file a second supplemental complaint to plead transactions occurring since the filing of the supplemental complaint and alleging additional damages in the amount of $650,000.00 for the period from January 31, 1962, to January 31, 1964 (R.T. 59A:12-24; C.T. 1283 et seq.).

Defendant made no objection to plaintiff's motion and the Court announced it would permit the filing of the second supplemental complaint. Plaintiff's proposed second supplemental complaint was served on defendant March 2, 1964 (C.T. 1286:27-29) and lodged with the Court April 3, 1964 (C.T. 1283).

Defendant was instructed to prepare pre-trial order No. 1 covering the Court's rulings at the March 2, 1964 hearing. Sunkist did not include in its proposed pre-trial order an order permitting the filing of plaintiff's second supplemental complaint. Plaintiff therefore submitted to the Court a substitute order covering the Court's oral announcements (C.T. 1311-1313 at p. 1313:5-7). The Court did not sign plaintiff's substitute order. Therefore at a hearing held May 18, 1964, the plaintiff reminded the Court of plaintiff's pending

motion to file a second supplemental complaint, and again the Court stated it would permit filing of such complaint (R.T. 92A:6-20).

At a hearing on October 12, 1964, and after plaintiff's records were complete, plaintiff asked leave to substitute a second supplemental complaint for the one previously lodged with the Court to accurately specify the damages in the amount of $806,000.00 for the period covered by the second supplemental complaint (R.T. 133A:1-134A:1). The Court stated plaintiff could make its motion on the second supplemental complaint on October 26, 1964, when there was scheduled defendant's motion to compel answer to certain interrogatories. The motion to compel answer to interrogatories was withdrawn, plaintiff having elected to answer the interrogatories (C.T. 1780). Hence there was no hearing on October 26, 1964.

Plaintiff, relying on the Court's oral pronouncements of March 2, 1964 and May 18, 1964, prepared its numerous exhibits to cover the complete period encompassed in the lawsuit from April 15, 1958 (original complaint) to January 31, 1964 (R.T. 136A:16-22; 139A:6-140:15).

On October 28, 1964, defendant filed a motion for an order prohibiting plaintiff from filing a second supplemental complaint (C.T. 1891-3). On November 9, 1964, the day before trial commenced, the Court announced it would not permit the filing of the second supplemental complaint (R.T. 134A:16-22) and an order prohibiting filing of the same was filed October 10, 1965 (C.T. 1925-26).

Early in April, 1961 (C.T. 1804) the parties had presented to the Court a stipulation of facts relating to Sunkist's, Exchange Orange's and Exchange Lemon's defense to the original complaint that they had complied with Sec. 1 of the Capper-Volstead Act and authorizing the Court to rule on that issue. The stipulation was not filed by the Court until October 27, 1964 (C.T. 1790, et seq.). However, prior to the filing or the reading by the Court of the stipulation relating to the Capper-Volstead defense, the Court had read the decision of the Supreme Court in *Sunkist Growers, Inc. v. Winckler and Smith Citrus Products Co.,* 370 U.S. 19 (1962) and had concluded that the Supreme Court in the *Winckler* case had ruled that Sunkist was an association organized in compliance with Sec. 1 of the Capper-Volstead Act and that the *Winckler* decision on this issue was binding on the plaintiff in the instant case (R.T. 5A:6-6A:6; 45A:3-18). Based on this conclusion, the Court in Pre-trial Order No. One, filed April 22, 1964, ruled that Sunkist, Exchange Orange and Exchange Lemon had complied with the provisions of Sec. 1 of the Capper-Volstead Act (C.T. 1307:10). In Pre-trial Order No. One the Court also ordered two separate trials of this cause: the first trial to cover the issue of liability and, if plaintiff prevailed, the second trial to cover the issue of damages.

Pursuant to the Court's ruling that defendants had complied with the Capper-Volstead Act, the Court in Pre-trial Order No. Two filed May 26, 1964, ordered that the issues of this cause were confined to whether

Sunkist had a monopoly on oranges grown in California and Arizona, whether it had illegally used any such monopoly power or had attempted to monopolize such oranges, and damages (R.T. 68A:6-12; 76A:17-25; C.T. 1359-60).

Trial was had from November 10, 1964, to November 30, 1964, when plaintiff rested (R.T. 1220:25). Defendant, without offering evidence, moved for a directed verdict (see motion for directed verdict lodged November 30, 1964, C.T. 1964-66, superseded by proposed order for directed verdict lodged December 28, 1964, C.T. 2056).

On March 1, 1965, the Court filed its memorandum and order granting defendant's motion for a directed verdict (C.T. 2093-2104). Final judgment was filed and entered pursuant to said order on March 2, 1965 (C.T. 2110-11).

II. THE EVIDENCE[2]

A. Description of the Parties.

Plaintiff and Plaintiff's Business. Plaintiff, a corporation, for all the period covered in this action (April 15, 1955 to January 31, 1962), had been engaged in the orange product manufacturing business (R.T. 433:13-20). This business consisted of the

[2]"The Evidence" relates to specification of error 1, and point I of Argument, namely, that the Court erred in granting defendant's motion for a directed verdict. Evidence particularly relating to plaintiff's other specifications of error is treated in argument thereon.

purchase of oranges and the manufacture of them into orange products for resale. Plaintiff's orange products were canned orange juice and blends of orange juice with other fruit juices. Plaintiff's orange products are single strength juices, that is, they are not concentrates but are the natural juices unmixed with water (R.T. 434:6-17).

The Defendants and their Business. As noted above, the action was commenced against Sunkist, Exchange Orange, and Exchange Lemon (corporations) but was dismissed as to Exchange Orange and Exchange Lemon when these defendants merged into the surviving corporation Sunkist, on October 31, 1958. After the merger, Sunkist carried on the functions that had been previously carried on by defendants Exchange Orange and Exchange Lemon in the Sunkist system (Admission 3(h), C.T. 1367:25-29, 1368:20). Hence, acts of Exchange Orange and Exchange Lemon refer to acts of these companies prior to their merger into Sunkist.

Sunkist, with its subsidiary corporation Exchange Orange, during the period covered by the complaint, acted as agent for the Sunkist organization in the following capacities: In the sale of oranges destined for retail consumption as fresh fruit; in the manufacturing of oranges into orange products and the sale of such products for resale and in the sale of oranges for product manufacture to other manufacturers of orange products (Plf's Exs. 1, 2; Admission No. 3, C.T. 1367:11-1368:26; R.T. 451:2-20). With respect to

Sunkist's handling of oranges for product use, Sunkist was vertically integrated with dual distribution. For products, it sold in competition with manufacturers of orange products who purchased orange supplies from Sunkist. (General Foods, R.T. 543:4-10; 549:12-550:3; Hyland-Stanford Co., R.T. 513:12 to 514:6; TreeSweet, R.T. 345:2-22; 706:13-25; Case-Swayne Co., Plf's Exs. 131, 132, R.T. 792:6-13; 823:2-17). Sunkist's dominant control of oranges grown in California and Arizona together with its vertical integration and dual distribution with respect to oranges designated for product use is the phase of Sunkist's operations that this cause is particularly concerned with.

Exchange Orange from the commencement of this action, April 15, 1958, until its merger into Sunkist October 31, 1958, was a 100% owned subsidiary of Sunkist; the Board of Directors of Exchange Orange consisted of the same Board of Directors as Sunkist (Admission No. 3(c) C.T. 1367:13-19; 1368:6-8). Exchange Orange was the adjunct of Sunkist for the sale of oranges for product use to manufacturers of orange products and for the manufacture of Sunkist orange products (Admission No. 3(e) and (f) C.T. 1367:21-24; 1368:12-18; R.T. 1108:7 to 1109:7). Exchange Lemon, from the commencement of this action and until its merger into Sunkist, was the manufacturing adjunct of Sunkist for the manufacture of lemon products from fresh lemons and it also manufactured orange products for Sunkist (Answer, C.T. 59:2-17; Admission No. 3(h) C.T. 1367:25-1368:26).

B. Interstate Commerce.

Oranges involved in this action were grown in California and Arizona; the oranges grown in Arizona are shipped all over the country. The orange products were shipped for resale throughout the various states of the United States and involved a continual stream of interstate commerce throughout the various states of the United States. Defendants at all times involved in this action carried on an interstate business in oranges grown in California and Arizona and orange products manufactured therefrom. (Admission No. 4, C.T. 1368:27-1369:11; R.T. 451:23-452:25).

C. The Product and the Relevant Market.

The product is oranges and specifically oranges utilized for the manufacture of orange products. Size and appearance can determine whether particular oranges should be diverted to product use. But that is not the sole factor in the determination of use of oranges for products. Oranges that can be sold as fresh fruit are utilized for product use in order to maintain fresh fruit prices. (Sunkist manager F. R. Wilcox, R.T. 951:16; 952:4; 966:2-8).

Substantially all oranges marketed in the United States are grown in California, Arizona, Florida and Texas (R.T. 454:1-4).

The relevant market in this cause was oranges grown in California and Arizona as defined in Pretrial Order No. Two, viz.,

> "(a) Did Sunkist have a monopoly of product oranges grown in the California-Arizona area?

(b) Did Sunkist illegally use any such monopoly power which it may have possessed?

(c) Did Sunkist attempt to monopolize product oranges grown in the California-Arizona area" (C.T. 1359:25-1360:6).

This was necessarily so because by reason of transportation costs plaintiff and other independent manufacturers of orange products had to obtain California- and Arizona-grown product oranges for their manufacturing activities in order to compete with manufacturers of orange products in the other orange growing areas of Florida and Texas (Plf's Pres. Amos Swayne, R.T. 439:1-440:2; Robert McCracken of TreeSweet Products Co., R.T. 86:4-20; the trial Judge, R.T. 982:14-24:

"Q. Would it be fair to say that manufacturers of orange products in California and Arizona had to purchase their fruit from California in order to operate economically their plants?

The Court: There is no dispute about that, is there, Mr. Henderson? The testimony has been that it would be uneconomical to try to ship fruit into California or Arizona from Florida or Texas. You have already established that. You are just accumulating evidence now. There is no dispute about that.")

Valencia oranges are the principal product oranges grown in California and Arizona. Single strength juice made from California *Valencia* oranges is the orange juice that is sold in competition with Florida's single strength juice. Single strength orange juice made from California *navel* oranges is generally sold

through government channels and the institutional trade (R.T. 486:22-25; 488:6-21).

Hereafter in this brief the term oranges will refer to oranges utilized for product use unless otherwise indicated.

D. Sunkist's Dominant Control of Oranges, Wrongful Use of Monopoly Power and Attempt to Monopolize.

1. Sunkist's Dominant Control of Oranges.

During the period involved, Sunkist controlled approximately 70% of all oranges grown in California and Arizona which embraced approximately 67% of such oranges diverted to product use. Other small cooperatives controlled *for their own* use approximately 18% of oranges grown in California and Arizona. The balance of the oranges (approx. 12%) represented those grown by independent growers and available to independent manufacturers, and were in the main handled by the Morgan Ward Co.

The evidence of this dominant control is shown in the following references: Plf's Exs. 92, 126, 124, 124A, 143; testimony of G. Herbert Holley of the Stanford Research, which testimony was the basis of Plf's Ex. 143 (R.T. 990-1020:15); testimony of Morgan Ward (R.T. 367:12-369:13); testimony of Carl Warnick with regard to Plf's Ex. 124A (R.T. 1189:1-1191:15 and defendant's Admission No. 7 R.T. 442:1 to 447:1; C.T. 1370:10-1371:10).

2. Sunkist's Wrongful Use of Monopoly Power and Attempt to Monopolize.

Sunkist's intention to control and utilize all oranges.

Sunkist obtained its oranges by contracts with citrus packing houses (which Sunkist refers to as "local associations"). When this action was commenced, such contracts were separate agreements between Sunkist and the packing houses (Plf's Ex. 1, the 1955 Sunkist District Exchange Agreement). In the reorganization of Sunkist of October 31, 1958 (wherein Exchange Orange and Exchange Lemon were merged into Sunkist) the citrus packing houses became members of Sunkist and the agreement providing for the sale of oranges by the packing houses to Sunkist was contained in the Sunkist amended articles of incorporation (Plf's Ex. 1A).

The contracts between Sunkist and the citrus packing houses, provide that the packing houses should enter into agreements with orange growers for the exclusive handling of growers' oranges by the packing houses and that the packing houses should market all oranges they controlled through Sunkist. Sunkist forbade the packing houses from "any contact with the trade, whether it originated with the shipper or the buyer, which deals with prices". Its prohibition was based on its assertion that "any contact with the trade which has the effect of undermining the sales representative falls within the spirit and probably the letter of By-law 9-4 cc." (Plf's Ex. 106, p. 2; R.T. 1125:11-1126:17).

Sunkist advertised to obtain growers for the Sunkist system (Plf's Ex. 103). It was the policy of Sunkist to obtain as many members as possible in the Sunkist system (Wilcox, R.T. 1117:14-16; Admission No. 6 C.T. 1369:25-1370:9). It organized Exchange Orange for the purpose of manufacturing into orange products all oranges it controlled and did not sell as fresh fruit (Wilcox, R.T. 1108:7 to 1109:7). Sunkist's position was that as a Capper-Volstead association it had the right to seek to control and use not only all the oranges in the relevant market (R.T. 1121:7-11; C.T. 1385:7-9; 1387:32-1388:6), but all the oranges in the United States. (R.T. 37A:9-25; 39A:11-25).

Boycott. Sunkist, with its vast accumulation of control over oranges, boycotted plaintiff from receiving oranges from Sunkist and the system it controlled. Sunkist in January or February, 1958, advised plaintiff it would not sell oranges to plaintiff or other independent manufacturers of orange products (R.T. 642:12-643:4). The action was commenced April 15, 1958. After the year 1957 and from then on plaintiff did not receive a pound of oranges from Sunkist (R.T. 647:8-24). By oral requests in July, 1959, in September, 1959, in January, 1960, in September, 1961, and by letter of plaintiff's counsel dated June 21, 1961, and by letter of plaintiff dated September 22, 1961, plaintiff requested Sunkist to let plaintiff know when Sunkist would sell oranges to plaintiff and that plaintiff at all times stood ready to purchase oranges from defendant. Sunkist never let plaintiff know and

never replied to plaintiff (Swayne, R.T. 648:1 to 665:1; Plf's Ex. 102).

While defendant was refusing to sell oranges to plaintiff, it was selling oranges generally to other manufacturers of orange products (Wilcox, R.T. 184:1-4). (Schedule B, Defendant's Answers to Plaintiff's 3rd Supplemental Interrogatories, Answers Nos. 4 and 5; C.T. 1693-1695).

In addition to boycotting plaintiff from Sunkist ranges, Sunkist prevented TreeSweet Products Co. rom delivering oranges to plaintiff that TreeSweet Products Co. had committed itself to deliver to plaintiff. Sunkist followed a truck of oranges it had sold o TreeSweet and discovering that the oranges were eing delivered to Case-Swayne successfully prevented rther deliveries that TreeSweet had committed to laintiff. This incident is related in the testimony of obert Buchheim, Vice-President of TreeSweet (R.T. 49:3-357:8; 371:19 to 372:23).

Price Control. Sunkist, by reason of its dominant ontrol of oranges grown in California and Arizona as able to establish the prices of product oranges in at market. There were so few other oranges avail-ble to independent processors that other sellers of anges could obtain for themselves the Sunkist price, hether established by Sunkist sales at its bid sys-m (hereinafter mentioned), or by outright sale. Dur-g the period Sunkist was not selling oranges the rice was established by Sunkist's anticipated returns r product oranges to the Sunkist growers. This was tablished by testimony of Morgan Ward, who

handled the oranges of independent growers and, who, after Sunkist, was the principal source of supply for independent manufacturers of orange products:

> "The Witness: Well, in the citrus by-product business, we know that Sunkist is the largest, and the days when they set a price, we followed that price. Then when they put out bids, we found out what those bids were, and if it was 2 or 3 days before we found out what was accepted, we waited until we found out what the top bid was, and then we billed our customers retroactively back, so that everybody in the citrus business were competitive. Then when Sunkist did not sell any fruit at all on any basis, then we would find out from their packing houses, we would talk to employees here and there and we would find out, 'Well, what do you think you are going to pay for by-products fruit?' 'Well', they would say, 'from the powers that be in Sunkist, we are going to receive so and so.' Then we would go from there and arrive at a price we thought would be comparable so that all would be equal in price in the State of California. That's the only way we could do it." (R.T. 374:19-375:13).

Morgan Ward's testimony was corroborated by testimony of Robert Buchheim (R.T. 334:18-335:23) and Robert McCracken (R.T. 123:15-125:3), both of Tree-Sweet. Robert McCracken, on cross-examination stated that Florida's high production and its prices were the dominating influence of the prices of product oranges in California. (R.T. 248:21-249:1). But on repetition of the question it became clear that what the witness meant was that Florida's production and prices might

ffect *Sunkist's* pricing, but obviously not other California sellers who followed Sunkist (Robert McCracken, R.T. 276:18-278:24):

"Q. Aren't these things we have been talking about, Mr. McCracken, the relative economic factors in California and Florida, and the dominant position of the Florida product in the nationwide, single nationwide market, aren't those the things that really control the price of product oranges, orange products, I mean single strength orange juice made in California, isn't it the dominating thing?

A. I don't know how Sunkist really estimates the returns to the packing house——

Q. I didn't ask you that.

A. Well, I have already testified to——

The Court: Just a minute. Don't override the witness.

Mr. Beardsley: I move that the answer be stricken as not responsive.

The Court: It may go out. I don't want you to override the witness. Our biggest problem, I think is that before the witness has answered, you want to ask him another question.

Mr. Beardsley: I am full of questions.

The Court: Maybe he can keep up, but the reporter can't. Have you got an objection?

Mr. Harmon: Yes, your Honor. It is difficult to hear the answer, and in addition if he sees that the answer isn't what he wants then he breaks in.

Mr. Beardsley: I object to that as a conclusion.

Mr. Harmon: It is a pretty obvious conclusion.

The Court: Let's go back and see how much of the answer the reporter got. (Whereupon the

answer was read by the reporter as follows: 'I don't know how Sunkist really estimates the returns to the packing houses . . .')"

Morgan Ward's answer to such question was as follows:

"By Mr. Beardsley: Q. Is it your opinion, then, that the market conditions with respect to Florida product oranges, have more effect on the price of product oranges in California than any other one factor?

A. They have effect on the over-all United States. Then those who set prices on the fruit in California look at what is going on all over the United States, and at that time the prices were set in California by the leading growers, Sunkist set it, using all those things to do it, I assume. But the price of by-products in this state has, ever since I have been in the business since 1934, been set by Sunkist. At one time it was called California Fruit Growers Exchange, and Sunkist at this time." (R.T. 392:1-14).

During the period encompassed in this action (1958-1962) Sunkist maintained high prices for Valencia product oranges. The orange products manufactured from oranges had to compete with like products manufactured by Florida manufacturers from Florida oranges. In every year but one during such period California prices for Valencia product oranges (from which competitive single strength juice was made) were higher than prices of Florida product oranges although Florida oranges contained higher sugar solids and more yield (Warnick, R.T. 1195:12-19; Plf's Exs.

44, 152; Swayne, R.T. 509:9-510:5; Robert McCracken, R.T. 276:3-5). Oranges could be purchased in Florida, processed in Florida and the single strength juice shipped to California and sold cheaper in California than juice processed in California from California oranges (R.T. 134:18-135:15).

Limiting Supplies. During the period involved, Sunkist decreased orange sales to its competing manufacturers of orange products until in 1958 it stopped sales. This was established by testimony of Carl Warwick (R.T. 611:25-614:2; and Plf's Ex. 97B (a graph showing the decline of sales by Sunkist of product ranges); and Wilcox, R.T. 1098:22-24).

Plaintiff's Ex. 88 shows the oranges plaintiff was able to obtain during the period of this lawsuit. Continuously throughout the period plaintiff sought to obtain oranges from all sources that might have fruit available to processors (Swayne, R.T. 670:21 to 691:).

TreeSweet did the same (R.T. 344:1-349:1; 359:14-7). TreeSweet had no trouble meeting its orange needs in Florida (R.T. 708:17-24).

General Foods (R.T. 546:12-15) and Hyland-Stanford Co. (R.T. 515:1-25; 528:13-20) were confronted with the same scanty supply and decreasing ability to obtain oranges to keep their plants operating in California (Wilcox, R.T. 980:11-16).

Sunkist had warned plaintiff and the other independent manufacturers of orange products that when the production of oranges in California and Arizona

dropped to a certain level, it would cease selling oranges to independent processors (Swayne, R.T. 640:3-641:8; Wendell K. McCracken, R.T. 722:2-22; Wilcox, R.T. 1075:5-1078:2). It repeated these warnings in its sale of Valencia product oranges in the bid system (R.T. 595:24-597:5; Plf's Ex. 14). The bid system was instituted in 1956, when Sunkist was progressively decreasing orange supplies to independent processors. The bid system was instituted by Sunkist for sale of all Valencia oranges. Sunkist offered less and less oranges for sale on the bid system until in 1957, processors must bid on unknown quantities of fruit that "may become available" or "it may not". (R.T. 595:7-596:8).

Plaintiff did not make bids on certain offers under the bid system where the prices under the bid system and plaintiff's evaluations indicated that a bid would be highly speculative (R.T. 579:17-24)—or under the 1957 offers where no quantity was specified and the bidder did not know whether he would get fruit when he made a bid (R.T. 592:22-25).

Elimination of General Foods Corporation. By reason of the squeeze of high prices of oranges, inadequate and diminishing supply, Sunkist's competitor General Foods Corporation discontinued its manufacturing of orange products in California in 1958 (Ingalls, R.T. 544:3-548:6). By letter of February 17, 1956, Sunkist through Exchange Orange had cancelled its consignment contract with General Foods (hereinafter discussed) advising General Foods that it appeared that "Exchange Orange Products Com-

pany can process all the fruit" (Plf's Ex. 10; R.T. 1079:7-1080:12). General Foods obtained oranges from Sunkist on the bid system and from wherever it could (R.T. 549:16-550:3). Before moving to Florida General Foods had engaged the Stanford Research Institute to conduct a survey with respect to availability of the orange product supplies in California and Arizona. The "prognosis" of the Stanford Research Institute showed that in view of Sunkist control of oranges there was little likelihood of sufficient supplies (Plf's Ex. 121; R.T. 999:18-999b:23).

Elimination of Hyland-Stanford Corporation. Hyland-Stanford Corporation, a competitor of Sunkist in the sale of orange products (R.T. 513:1-23), who during the period involved obtained its oranges entirely from Sunkist (R.T. 514:4-6), discontinued manufacture of orange products in California in October, 1955, by reason of insufficient oranges to maintain and operate its manufacturing plant. This is eloquently established by letter dated January 3, 1956, of Lee C. Ward, President of Tru-Ade Co. (Plf's Ex. 10C; R.T. 1081:13-1084:4) which company had acquired control of Hyland-Stanford (R.T. 517:23-5). Mr. Ward wrote Exchange Orange that he was one of those "in the industry depending upon you as a source of supply". He offered to maintain and operate the Hyland-Stanford plant on "a ready-to-produce basis" if Exchange Orange would supply sufficient oranges to manufacture for account of Exchange Orange a minimum of "180,000 gallons 65° brix (orange juice) concentrate".

Ward was advised by Sunkist "that we could not do it." (R.T. 1081:13-1084:3). (The processing for Sunkist referred to was under contract whereby Sunkist consigned oranges controlled by Sunkist for manufacture of products for the account of Sunkist, which contracts are hereinafter discussed.)

In April 1955 Sunkist had determined it could process all its fruit, had decided to terminate sales of Valencia oranges to outside processors as rapidly as possible and Hyland-Stanford and other processors had been notified (R.T. 1075:5-1078:2). Sunkist's processing contract with Hyland-Stanford was terminated by letter dated February 17, 1956.

Construction of Florida Plant by TreeSweet Products Co. TreeSweet, a Sunkist competitor in the sale of orange products (R.T. 706:7-25) constructed a plant in Florida in 1955 because it was unable to obtain enough oranges to supply its market in California (R.T. 708:9-21; 725:15-23). It shipped the single strength juice manufactured in Florida to California to sell in California (R.T. 729:24-730:5). TreeSweet was one of the first packers of single strength juice, a leader in the field perhaps packing "more single strength juice than anyone else in California" (R.T. 705:4-15). TreeSweet obtained most of its oranges from Sunkist (R.T. 708:6-8).

Espionage, Threats, Coercion, and Fines to Enforce Sunkist Agreements with Packing Houses. The Sunkist trademark, a valuable emblem for the sale of fresh oranges, was the powerful lever whereby Sun-

ist was able to induce growers to join Sunkist via a trus packing house under a contract whereby if ney marketed fresh oranges under the Sunkist label rough Sunkist they must also market their product anges through Sunkist. Millions of dollars were ent in advertising the label, coming from grower sessments (R.T. 1079:9-25).

Sunkist manager Wilcox was the Sunkist officer harged with forcing the packing houses to market eir product oranges through Sunkist when they ould have preferred selling them to independent ocessors (R.T. 1032:2-11). The Sunkist enforcement policy was instigated after a short interval during which period Sunkist gave packing houses a oice to sell product oranges to independent processors or market them through Sunkist (R.T. 1023:5-26:9; Plf's Ex. 25).

The testimony of Manager Wilcox (R.T. 1028:6-70:6) and Sunkist records (Plf's Exs. 21, 22, 24, 25, , 29, 30, 31, 35, 36, 37, 38, 39, 40, 42, 47, 133 and T. 1690:1-1692:1) show the following "corrective tion" by Sunkist: Espionage on packing houses cluding the following of their trucks (Placentia ange Growers Assoc. R.T. 1039:18-1040:11; Fonaa-Rialto Citrus Assoc. 1047:1-1048:9; Grandview ights Citrus Assoc. R.T. 1060:12-1061:14); threats cancel membership in the Sunkist system (R.T. 29:18-1030:12; 1057:1-1059:13); referring the mat- to a Sunkist tribunal, the "Advisory Committee", consider violations of sale of oranges and recomnd the penalty (R.T. 1028:16-24) followed by the

assessment of liquidated damages (R.T. 1056:4-16; 1067:7-25) or recommendation of cancellation of the Sunkist contract (R.T. 1058:9-15).

The forcing of citrus packing houses to market oranges for product use only through Sunkist was a continuous project with Sunkist. Since the commencement of this action Sunkist has taken what it terms "corrective action" in cases to force its members to market oranges for product use as well as oranges for fresh consumption through Sunkist. These "corrective" measures included assistance to one of its packing houses in litigation against Thomas A. Wilson and Huber G. Wilson; assessment of liquidated damages against Grandview Heights Citrus Assoc.; "warning" letters to Rialto Orange Co., district Exchanges Tapo Citrus Assoc., Earlybest Orange Assoc. and Klink Citrus Assoc. and discussion with district exchange manager re Airdrome Express, Inc. (Interr's, C.T. 1690:1-1962:1). Space does not permit recounting all incidents. We refer the Court to the references to the reporter's transcript, the exhibits and the clerk's transcript, cited above.

Plaintiff was a specific target of Sunkist's "corrective action" during the brief period in 1957 when Sunkist permitted its citrus packing houses to sell oranges to independent processors. The Placentia Orange Distributors (a Sunkist unit), promised plaintiff 5,000 tons of oranges. After Sunkist's change of policy Sunkist would not permit Placentia to fulfill the promise Placentia had made while it was free to sell oranges to plaintiff (R.T. 674:3-679:16).

Consignment Contracts. During periods when Sunkist's manufacturing facilities were insufficient to handle all oranges it controlled, and rather than make its surplus available to independents, Sunkist entered into consignment contracts with manufacturers of orange products including General Foods Corp., Hyland-Stanford Corp., Mission Dry Co. (R.T. 1078:3-9; Plf's Exs. 52, 53). Sunkist supplied oranges and grapefruit, retained ownership of the same and products manufactured therefrom. Since the commencement of this action consignment contracts were also entered into with Anaheim Processors and Holly-Pac. (C.T. 1697:1-32). General Foods and Hyland-Stanford were permitted to purchase some of the products they manufactured (Admission 8, C.T. 1371:12-1372:2).

The quantity of oranges processed by General Foods during the period of this action was small, but the grapefruit was more substantial (Ingalls, R.T. 559:2-13). The processing of Sunkist's grapefruit (as well as Sunkist's oranges) under the consignment contracts freed Sunkist facilities to process more oranges and thereby decreased the supply of oranges available for independent manufacturers of orange products because substantially the same processing machinery is used in the manufacture of grapefruit products as is used in the manufacture of orange products (R.T. 556:17-19). Thus, utilizing consignment contracts for manufacture of either grapefruit or oranges enabled Sunkist to utilize its machinery for manufacture of orange products (Ingalls, and the

Court, R.T. 559:12-560:9). Exchange Lemon also manufactured orange products for Sunkist (Answer C.T. 159:2-17; and Admission, C.T. 159:2-17; Admission 3(h) C.T. 1367:25-1368:26).

When the outlook for orange production was such that Sunkist concluded that its manufacturing facilities would be adequate to handle all oranges it controlled, Sunkist cancelled the consignment contracts with General Foods, Hyland-Stanford and Mission Dry Co. (Plf's Exs. 10, 10A, 10B; R.T. 1075:5-1078:2; 1079:4-1087:18).

Sunkist's prognostication of California orange production and its ability to process all oranges it could control did not prove out. After 1958 orange production in California and Arizona started on the increase (Wilcox, R.T. 1184:5-1187:19; Plf's Ex. 97A; Warnick, R.T. 622, et seq.). Sunkist found itself with oranges it could not process. It sold some of these oranges to manufacturers of orange products other than plaintiff, and others were retained on consignment contracts, as above stated.

In 1956 and 1957 Sunkist made use of its position of dual distribution to depress the prices of single strength orange juice after manufacturers of single strength juice had purchased their orange supplies at Sunkist prices. This resulted in plaintiff losing money. (Paul Case, plaintiff's Vice-president and Plf's Ex. 131; R.T. 786:6-795:25).

In 1956 Sunkist made a bid to furnish orange juice to the United States Department of Agriculture on

he department's school lunch program. The bid was 9¢ per case less than a Sunkist bid to the Department of Agriculture in 1955 on the *same* product *and* he same quantity (Plf's Exs. 148, 149) although ranges were commanding a higher price in 1956 and range products were bringing a higher return (Plf's x. 151). Information on the school lunch program as known to all the industry (R.T. 552:1-18). The range supply was "tight" in 1956 (R.T. 551:22-25). eneral Foods sent a protesting letter to the Department of Agriculture on the Sunkist bid but the Court ould not admit it in evidence (R.T. 553:2-17; Plf's x. 129 for identification). TreeSweet sent a letter nd a telegram to the Department of Agriculture protesting the Sunkist bid which the Court likewise refused to admit in evidence (R.T. 714:1-715:4; Plf's xs. 127, 128 for identification).

Increased Returns and Elimination of California ingle Strength Juice. After Sunkist ceased sales to ndependent manufacturers in 1958, its income soared. he year 1958 was the lowest year in history for production of oranges in California and Arizona, but it as the second highest income year for Sunkist Plf's Ex. 87a; Warnick, R.T. 624:3-625:2) since Vorld War II. The Sunkist income was $183 million, n increase of $13 million over the previous year. unkist's increased income was proclaimed by Manger Wilcox to the Los Angeles Times (Plf's Ex. 112; .T. 1104:4-1105:24).

The secret of high income from low quantity is revealed in the Cold Gold transaction. Cold Gold Co.

was an orange purchaser from Sunkist before Sunkist stopped selling oranges to processors in 1958 (R.T. 1098:15-1099:2). Sunkist thereafter sold Cold Gold bulk orange juice (product No. 8) in lieu of oranges. Prices increased from $.048 per gallon to $.087 per gallon on this substitute for oranges (R.T. 1102:17-1103:11; Plf's Ex. 108). Single strength juice manufactured from oranges in California and Arizona has been practically eliminated from the market while the production of this product has held its own in Florida and Texas (Plf's Ex. 7A; Warnick, R.T. 1193:5-19).

SPECIFICATION OF ERRORS

1. The District Court erred in granting defendant's motion for directed verdict and ordering judgment thereon.

2. The District Court erred in ruling that Sunkist, Exchange Orange and Exchange Lemon were organized in conformance with Sec. 1 of the Capper-Volstead Act and therefore they could not be held in violation of Sec. 1 of the Sherman Act, for conspiring with one another to restrain and monopolize trade in product oranges.

3. The District Court grossly abused its discretion in denying appellant's motion to file a second supplemental complaint.

4. The trial judge displayed such marked prejudice and bias against appellant that if the judgment is reversed, trial of the cause should be held before another judge.

SUMMARY OF ARGUMENT

The Court Erred in Directing a Verdict in Favor of Defendant.

This argument assumes (for the purpose of argument only) that Sunkist Exchange has complied with the provisions of Sec. 1 of the Capper-Volstead Act, which plaintiff challenges, in Point II, infra.

A Capper-Volstead cooperative is liable under Sec. of the Sherman Act for wrongful use of monopoly power and attempt to monopolize.

The evidence was sufficient for the jury to find that Sunkist wrongfully used monopoly power. Such evidence includes: Sunkist domination of the orange industry; boycott of oranges to plaintiff; preventing TreeSweet from delivering oranges committed to plaintiff; establishing high orange prices and limiting supplies so that competitors General Foods and Hyland-Stanford were eliminated from the market and competitor TreeSweet was forced to construct a plant in Florida to meet its California demand for single strength juice; and other acts mentioned below on Sunkist's intent to monopolize.

The evidence was sufficient for the jury to find Sunkist attempted to monopolize oranges.

Intent to monopolize (an element of attempt to monopolize) is not determined by accepting the professions of alleged monopolists or by scrutinizing each item of evidence separately,—but by viewing the evidence *as a whole*. Sunkist's intent is shown by the following evidence: Admitted purpose to control and utilize all oranges; boycott of plaintiff; preventing

TreeSweet from fulfilling commitment to plaintiff; maintenance of high orange prices and elimination of competitors; preventing a Sunkist packing house from fulfilling promise of oranges to plaintiff; policing the Sunkist system to prevent sales to independent manufacturers; wrongful use of dual distribution by squeezing prices on single strength orange juice; use of consignment contracts and low bid on orange juice to Department of Agriculture to limit oranges available to independent manufacturers.

II. Sunkist, Exchange Orange and Exchange Lemon Were Not Organized in Compliance With Section 1 of the Capper-Volstead Act 5 U.S.C. Sec. 371.[3]

Section 1 of the Capper-Volstead Act as applied to Sunkist, Exchange Orange and Exchange Lemon requires that members of a cooperative must be fruit growers who market the fruit they grow through the cooperative, or a cooperative member must be such a cooperative. A substantial number of Sunkist members from whom Sunkist obtained a substantial quantity of its oranges were *not* fruit growers, were *not* cooperatives composed of fruit growers, but were either private profit-making corporations or individuals or partnerships that admittedly did not comply with Sec. 1 of the Capper-Volstead Act. Exchange Lemon was similarly organized. Exchange Orange was a 100% owned subsidiary of Sunkist. The decision of the Court in *Sunkist Growers, Inc. v.*

[3]The defense of Section 6 of the Clayton Act is deemed embraced within the issue of defendant's alleged compliance with Section 1 of the Capper-Volstead Act.

Vinckler and Smith Citrus Products Co., 370 U.S. 19 (1962) involved different issues between different parties on a different record.

I. The District Court Grossly Abused Its Discretion in Denying Appellant's Motion to File a Second Supplemental Complaint.

Plaintiff's motion to file a second supplemental complaint was to allege Sunkist's continuing wrongful use of its continuing monopoly power and continued attempt to monopolize since the filing of plaintiff's supplemental complaint. The pleading was squarely within the provisions of Rule 15(d) Federal Rules of Civil Procedure. The motion was not objected to by defendant when the motion was made. The Court's ground for denying the motion, that there was no motion before it, is contradicted by the record.

V. The Trial Judge Displayed Such Marked Prejudice and Bias Against Plaintiff That If the Judgment Is Reversed Trial of the Cause Should Be Held Before Another Judge.

A trial judge's unwarranted prejudgment of a cause demonstrated in the trial requires the appellate Court upon reversal to order the new trial before another judge. The trial judge's participation in the cause by indicating to the jury that plaintiff's evidence showed no wrongdoing by Sunkist and showing his alignment with defendant, the circumstances and grounds of his adverse rulings against plaintiff on the Capper-Volstead issue and plaintiff's motion to file a second supplemental complaint demonstrated that the trial judge had prejudged this cause.

ARGUMENT

I. THE DISTRICT COURT ERRED IN GRANTING DEFENDANT'S MOTION FOR DIRECTED VERDICT AND ORDERING JUDGMENT THEREON.

A. Introductory.

This argument is premised on the assumption (made for the purpose of this argument only and disputed in Point II, infra) that Sunkist during all the times involved in this action had conformed with the requirements of Sec. 1 of the Capper-Volstead Act and therefore was entitled to such immunity from Sec. 2 of the Sherman Act as the Capper-Volstead Act affords.

The word "cooperative" in the following discussion will be used as referring to an association that has complied with Sec. 1 of the Capper-Volstead Act.

B. Sunkist Wrongfully Used Monopoly Control of Oranges and Attempted to Monopolize Oranges in Violation of Section 2 of the Sherman Act.

1. A Cooperative Is Liable Under Section 2 of the Sherman Act for Wrongful Use of Monopoly Power and for Attempt to Monopolize.

The Supreme Court in *Maryland and Virginia Milk Producers Assn., Inc. v. United States,* 362 U.S. 458 (1960), settled the proposition that a cooperative is an entity; and that apart from carrying out the legitimate objects of the cooperative it may be held accountable under Section 2 of the Sherman Act for monopoly and attempts to monopolize to the same extent that a private business corporation may be held accountable. The Supreme Court's decision in the *Milk Producers* case was presaged by its earlier de-

ision in *United States v. Borden Co.*, 308 U.S. 188 1939), wherein it ruled that cooperatives that conpired with outsiders could be held accountable under he provisions of Sec. 1 of the Sherman Act.

The question of the responsibility of a cooperative or monopoly and attempts to monopolize under Sec. of the Sherman Act was squarely presented in the *Milk Producers* case. The cooperative involved in hat case controlled about 86% of the milk in the Vashington, D.C. area. One charge of the complaint vas that the cooperative had attempted to monopolize nd had monopolized trade in milk in violation of ec. 2 of the Sherman Act. It was alleged that the ooperative had threatened and taken action to induce r compel dealers to purchase milk from the cooperative, induced and assisted others to acquire dealer utlets and attempted to eliminate others from supplying milk to dealers by such conduct as attempting o interfere with truck shipments of non-members' ilk, inducing others to switch from non-members nd boycott. The district Court ruled that this charge vas insufficient in that it was not alleged that the ooperative had conspired with outsiders, and it dismissed the charge.

The Supreme Court reversed the district Court's ismissal of the monopoly charges, remanding the ause for trial of such charge, stating:

> "And the House Committee Report assured the Congress that: 'In the event that associations authorized by this bill shall do anything forbidden by the Sherman Antitrust Act, they will be

> subject to the penalties imposed by that law.' Although contrary inferences could be drawn from some parts of the Legislative history, we are satisfied that the part of the House Committee Report just quoted correctly interpreted the Capper-Volstead Act, and that the Act did not leave cooperatives free to engage in practices against other persons in order to monopolize trade, or restrain and suppress competition with the cooperative."

Time and time again the Supreme Court has cited the *Milk Producers* case and stood by it. *California v. Federal Power Commission,* 369 U.S. 482, 485 (1962); *Sunkist Growers, Inc. v. Winckler and Smith Citrus Products Co.,* 370 U.S. 19, 30 (1962); *Continental Ore Co. v. Union Carbide and Carbon Corp.,* 370 U.S. 690, 709 (1962); *United States v. Philadelphia National Bank,* 374 U.S. 321 (1963).

Since the *Milk Producers* case, two lower Federal Courts have ruled flatly that when a cooperative steps beyond the serving of the legitimate functions of its members and wrongfully uses monopoly power or attempts to monopolize to injure outsiders, the cooperative is accountable for treble damages for violation of Sec. 2 of the Sherman Act as is any other corporate entity.

In *Bergjans Farm Dairy Co. v. Sanitary Milk Producers,* 241 Fed. Supp. 476 (E.D. Mo. 1965), the cooperative controlled over 55-60% of raw milk in the relevant market. It purchased processing plants and engaged in dual distribution, selling some milk

aw and selling other milk as processed milk. Its ontrol of 55-60% of the raw milk gave it power to ontrol prices of raw milk and hence power to squeeze ie profits of its competitors by cutting the price of rocessed milk. It exercised this power and indeendent processors who were injured thereby recovred damages for their losses. The Court ruled that ie exemptions under Secs. 1 and 2 of the Capper-'olstead Act and Sec. 6 of the Clayton Act

> ". . . do not apply to actions of an agricultural cooperative with respect to other non-cooperative corporations or individuals and as to these an agricultural cooperative is subject to the anti-trust laws the same as any other corporation or person. *Maryland & Virginia Milk Product Assn. v. United States.*"

The Court ruled that monopoly power, whether, ained lawfully under the Capper-Volstead Act, under he Patent laws, or by virtue of a natural monopoly, f used unlawfully gives rise to a violation of Sec. 2 f the Sherman Act and amounts to unlawful monoplization, or attempt to monopolize, stating:

> "Great economic power denotes great responsibility in its use because the possibility of injury is so great. *United States v. Aluminum Co. of America,* supra. Sanitary used the economic power of its position as a producer's cooperative to acquire the Quality of O'Fallon plant. It then used the control over the Quality of O'Fallon plant to put itself in the position of being both a competitor with and a supplier to the milk producers in St. Louis and St. Louis County."

334 U.S. 131 (1948); *United States v. Aluminum Co. of America,* 148 F. 2d 416 (2nd Cir. 1945). And when the issue is monopolization, as perhaps distinguished from attempt to monopolize, the requirements of intent are not so demanding and "It is sufficient that a restraint of trade or monopoly results as the consequence of a defendant's conduct or business arrangements." *United States v. Griffith,* supra, at p. 105.

But plaintiff's case does not rest merely on Sunkist's *power* to control prices and exclude competitors and necessary intent. Sunkist wrongfully *exercised* its monopoly power by predatory acts, against plaintiff particularly and against other competing manufacturers of orange products generally. Hence plaintiff's case was embraced within the principles and rulings of the Courts in the *Milk Producers* case, *Bergjans Farm Dairy Co. v. Sanitary Milk Producers,* and *North Texas Producers Assn. v. Metzger Dairies, Inc.,* supra.

It is submitted that the following items of evidence as more fully mentioned in the Statement of the Case would have been sufficient to support a jury's finding that Sunkist wrongfully used monopoly power in violation of Sec. 2 of the Sherman Act.

Boycott. The vast Sunkist organization has boycotted plaintiff and refused to sell plaintiff oranges from the commencement of this action while selling oranges to other manufacturers of orange products "generally" (R.T. 657:8-24; 648:1-665:11; 1184:1-4 C.T. 1693 and Schedule B attached). Size itself is no

wrongful unless, as was stated by Justice Cardozo in *United States v. Swift and Co.,* 286 U.S. 106, 116 (1932), size is "magnified to a point where it amounts to a monopoly". But great size is always an earmark of monopoly. *United States v. Griffith,* supra. Boycott of plaintiff by the mammoth Sunkist organization was wrongful use of monopoly power. *United States v. New York Great Atlantic and Pacific Tea Co.,* 173 F. 2d 79, 87 (7th Cir. 1949).

Preventing TreeSweet from delivering oranges TreeSweet had committed to deliver to plaintiff. Sunkist followed a truck of oranges and finding they were delivered to plaintiff prevented TreeSweet from making further deliveries in fulfillment of TreeSweet's commitment to plaintiff (R.T. 343:3-357:8; 371:19-372:23).

Control of orange prices. Sunkist dominated orange prices and established Valencia orange prices above those existing in Florida (Warnick, R.T. 1195:1-1196:21 and Plf's Ex. 144; R.T. 509:22-510:5; 276:3-; Plf's Ex. 104).

It may be noted that the lower court, in its memorandum and order granting defendant's motion for directed verdict, mystically arrived at opinion that the relevant market for product oranges encompassed the entire United States and relied upon the case of *United States v. E.I. duPont de Nemours & Co.,* 351 U.S. 377, supra (C.T. 2102:7-2104:5). Thus the Court repudiated its own Pre-trial Order (C.T. 1359-60), the understanding of both the attorneys for plaintiff and

defendant of the issues (R.T. 783:20-785:5), and the evidence in the case, which the Court had stated was undisputed, that manufacturers of orange products in California by reason of transportation costs had to depend upon oranges grown in California and Arizona in order to compete with manufacturers in other orange production areas. Further, in the *duPont* case the product was flexible wrapping paper, the relevant market was alleged nationwide; duPont, with its wrapping paper named cellophane, handled about 18% of the relevant market; cellophane had "to meet competition from other materials in every one of its uses" and duPont "could not exclude competitors even from the manufacture of cellophane."

Elimination of competitors. Sunkist's domination of orange prices and supply gave it power to eliminate competitors (or, as with plaintiff, limit their profits) by maintaining high prices for oranges or reducing supplies. Sunkist did both. Sunkist's maintenance of high orange prices coupled with its limiting of supplies forced General Foods Corp. and Hyland-Stanford to abandon their manufacture of orange products in California. It caused TreeSweet Products Co. to construct an orange processing plant in Florida in order to supply its market for single strength juice in California (R.T. 374:19-375:13; 334:19-335:23; 123:15-125:3).

Sunkist's soaring income after it cut off orange supplies and eliminated competitors such as General Foods, Hyland-Stanford (R.T. 544:5-548:6; 513:1-23; 514:4-6; 1081:13-1084:3) and after such cut off had

ompelled companies like Cold Gold to purchase prod-
ts instead of oranges (R.T. 1098:15-1099:2; 1102:
-1103:11) indicated that monopoly power had been
nerated. *United States v. General Electric Co.,* 82
ed. Supp. 753, 895 (D.N.J. 1949).

Additional evidence of Sunkist's wrongful use of
onopoly power is mentioned in argument re Sun-
ist's attempt to monopolize, following. For evidence
wrongful use of monopoly power and attempt to
onopolize overlaps. The statement of the Supreme
ourt in the *Milk Producers* case, 362 U.S. at p. 463
specting Sections 1, 2, and 3 of the Sherman Act is
plicable: "these sections closely overlap, and the
me kind of predatory practices may show violations
all."

Sunkist Attempted to Monopolize Oranges Grown in California and Arizona.

The intent motivating the conduct of a party plays
commanding role as to whether such conduct, which
ight otherwise be lawful, violates the antitrust laws.
he intent of a party motivating his conduct may be
terminative of whether such conduct constitutes an
tempt to monopolize in violation of Sec. 2 of the
herman Act. *Bergjans Farm Dairy Co. v. Sanitary*
ilk Producers, supra; *Picayune Publishing Co. v.*
nited States, 345 U.S. 594, 626 (1953); *United*
tates v. Columbia Steel Co., 334 U.S. 495 (1948);
nited States v. Griffith, 334 U.S. 100, 105 (1948);
nited States v. Paramount Pictures, Inc., 334 U.S.
1 (1948); *United States v. American Tobacco Co.,*
1 U.S. 106 (1911).

Monopolists do not admit bad intent. Hence, proof of intent is generally circumstantial and determined from viewing the conduct of the party and the circumstances surrounding his acts. The issue of good or bad intent is not determined by paying lip service to protestations of innocence by a defendant charged with violation of the antitrust laws. *United States v. Parke, Davis & Co.,* 362 U.S. 29, 44 (1960); *Eastern States Retail Lumber Dealers' Assn. v. United States,* 234 U.S. 600, 612 (1914); *Standard Oil Co. of California v. Moore,* 251 F. 2d 188 (9th Cir. 1958) Cert. denied, 356 U.S. 975 (1958); *American Tobacco Co. v. United States,* 147 F. 2d 93, 106 (6th Cir. 1944), aff'd 328 U.S. 781 (1946).

Nor is intent ascertained by viewing each facet of a cause separately. As stated by the Court in *Continental Oil Co. v. Union Carbide and Carbon Corp.,* 370 U.S. 690, 699 (1962):

> "In cases such as this, plaintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each . . . the character and effect of a conspiracy cannot be judged by dismembering it and viewing its separate parts, but only by looking at it as a whole."

Further, plaintiff, on a judgment based on order directing a verdict against plaintiff must have had the benefit of all reasonable inferences as against contrary reasonable inferences that might be drawn from the evidence. *Continental Ore Co. v. Union Carbide and*

arbon Corp., 370 U.S. 690, 696, 699 (1962); *Schulz v. ennsylvania Rd. Co.,* 350 U.S. 523, 524, 526 (1956); *allick v. Baltimore and Ohio Rd. Co.,* 372 U.S. 108 1963).

Appellant submits: There was sufficient evidence or a jury to find that Sunkist intentionally at- mpted to monopolize the trade in product oranges the relevant market. Further, that such intent was personally" directed at plaintiff.

We refer to the following items of evidence, more lly stated in the statement of the case as sufficient support a finding of a jury that defendant at- mpted to monopolize oranges grown in California d Arizona in violation of Sec. 2 of the Sherman ct.

Defendant's admitted purpose to control and proc- s all product oranges. Sunkist admitted its purpose control all the oranges it could control with inten- on to utilize all of them in its manufacturing facili- es (R.T. 1117:14-16; Admission No. 6, C.T. 1369:25- 370:9). It is noticed that this same intention existed the case of *Bergjans Farm Dairy Co. v. Sanitary ilk Producers,* supra.

Boycott of oranges to plaintiff. As stated supra, e vast Sunkist organization refused to sell oranges plaintiff while selling oranges generally to other anufacturers.

Preventing delivery of oranges to plaintiff by Tree- weet. As stated supra, Sunkist even stopped Tree-

Sweet from delivering oranges to plaintiff which TreeSweet had committed to deliver to plaintiff.

Preventing Placentia Orange Distributors from fulfilling its promise to plaintiff. Sunkist demonstrated its intent to injure plaintiff when in 1957 it prevented Placentia Orange Distributors, a member of its system, from fulfilling a promise to sell plaintiff 5,000 tons of oranges for that year. It had promised these oranges to plaintiff during the short period Sunkist permitted packing houses to sell product oranges to independent processors (R.T. 674:3; 679:16).

Policing the Sunkist system to punish violators of the Sunkist restrictive tying contracts. Sunkist policed the citrus packing houses in its system who were under restrictive tying agreements to market product oranges as well as oranges destined for fresh fruit through Sunkist and to deal exclusively with Sunkist. Indeed, Sunkist interpreted its contracts as prohibiting the packing houses "from even contracting the trade on prices" (R.T. 1028:6-1070:6; 1125:11-1126:17). Whether or not a cooperative may bind suppliers by such contracts in the light of *Northern Pacific Railway v. United States,* 356 U.S. 1 (1958) is one thing. But the contracts and Sunkist's conduct in policing the same by espionage, threats and fines were a clear demonstration of purpose to monopolize.

Wrongful use of dual distribution. The jury was entitled to infer that Sunkist's lowering of prices of single strength juice after competing manufacturers had purchased their oranges at high prices established

Sunkist (R.T. 786:6-795:25) was intentionally done squeeze the profits of these manufacturers and nce constituted predatory conduct.

Consignment contracts. Sunkist's consignment contracts further decreased the orange supply. While nsignment contracts can be valid marketing contracts, they are susceptible to anti-competitive devices. *impson v. Union Oil Co.*, 377 U.S. 13 (1964). Sunst did not use the consignment contracts to market anges, but rather, to continue control of the oranges. the light of all the evidence, a jury was entitled to fer that Sunkist used consignment contracts so that e oranges would not be available to independent anufacturers. When Sunkist conceived it could ocess all oranges it controlled it terminated the conmment contracts (R.T. 1079:4-1080:18; 1075:5-78:2).

Sunkist's bid to the Department of Agriculture. nkist's low bid to the Department of Agriculture r the furnishing of orange juice (Plf's Exs. 148, 9, 151) is in a similar category. Standing alone, the cident would have little significance. But considered the light of the other evidence in the cause (including the scarcity of oranges), the fact that the bid was bstantially lower than the previous year's bid when ange products were considerably higher, the dignant reaction of independent manufacturers (not mitted) which spoke eloquently of the orange situaon, the jury was entitled to infer that a low bid was liberately submitted in order to decrease the orange pply.

II. THE DISTRICT COURT ERRED IN RULING THAT SUNKIST, EXCHANGE ORANGE AND EXCHANGE LEMON HAD COMPLIED WITH SECTION 1 OF THE CAPPER-VOLSTEAD ACT.

If the Sunkist system is removed from the protection that the Capper-Volstead Act does afford to bona fide grower-cooperatives, then there is not even a phantom of defense to one of the most elaborate and powerful and repressive conspiracies and combinations to restrain trade in violation of Sec. 1 of the Sherman Act that has ever existed in the history of antitrust law.

We believe the issue presented with respect to Sunkist's, Exchange Orange's, and Exchange Lemon's alleged compliance with Sec. 1 of the Capper-Volstead Act is one of original impression.

The issue is not complicated. Plaintiff's position is based upon the first sentence of Sec. 1 of the Capper-Volstead Act which provides:

> "That persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged."

Plaintiff's position is that the above quoted provision must be construed as providing that members of a cooperative *must be growers* that market *the product they grow* through the cooperative they organize.

Further, it is accepted that the provisions are complied with if the members of the cooperative consist o

ch cooperatives. For this was the conclusion of the ipreme Court in *Sunkist Growers, Inc. v. Winckler Smith Co.,* 370 U.S. 19, supra, in viewing the Sunst system.

Sunkist. Specifically, then, as relating to Sunkist, e Sunkist members must consist of cooperatives. his is *not* the Sunkist situation. The Sunkist members from whom Sunkist obtained its fruit are citrus cking houses. Prior to the reorganization of Sunkist ctober 31, 1958, the citrus packing houses were not rect members of Sunkist but were members of strict exchanges who were members of Sunkist. By e reorganization of October 31, 1958, the citrus cking houses became direct members of Sunkist tipulation of Relevant Facts and Material Issues of w Relative to Issues Raised by the Capper-Volstead fense, C.T. 1790 et seq.; Sunkist Amended Articles Incorp., Sunkist Growers, Inc.; Plf's Ex. 1A).

The Court will notice that in the stipulation and in nkist's Amended Articles of Incorporation as well in the Sunkist 1955 District Exchange Agreement, ese citrus packing houses are referred to collectively "associations." Even more confusing, these citrus cking house members are likewise referred to as ssociations" in Sunkist's brief to the Supreme ourt in the *Winckler* case, part of which brief is reinafter quoted.

Sunkist's employment of the term "associations" in ferring to *all* of its citrus packing house members a highly deceptive self-serving denomination.

Here is the composition of the Sunkist citrus packing house members as stipulated to by the parties 14.91% of these members (and 12.94% by volume of the oranges marketed by Sunkist) are *not* associations and are *not* cooperatives and are *not* growers. They are private profit-making corporations or individually owned enterprises and partnerships "which do not qualify as, nor do they claim to be cooperative associations under Sec. 1 of the Capper-Volstead Act." (Capper-Volstead stipulation, C.T. 1793:17-28 "agency members"). These private profit-making corporations or individuals or partnerships who are members of Sunkist *do not grow fruit.* The fruit they market through Sunkist is *purchased* from growers. (See Ex. B attached to Capper-Volstead Stipulation a contract between such citrus packing house and growers *"which may be deemed as typical",* C.T. 1821-1822).

An additional 4.97% of the members by number (4.72% by volume) are ordinary corporations which grow citrus but which "do not qualify as, nor are they claimed to be, cooperative associations under Section of the Capper-Volstead Act" (C.T. 1793:4-16).

The make-up of Sunkist members as containing private profit-making corporations, individuals and partnerships as well as cooperatives is also established by Sunkist's answer to Plaintiff's Request for Admission No. 15 (C.T. 1375:1-21).[4]

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[4]In answer to Plaintiff's Interrogatory Nos. 9 and 11, Plaintiff's 3rd Supp. Interr's, Sunkist "dodged" this question, citing the Court's ruling in Pre-trial Order No. 1.

We submit: The first sentence of Sec. 1 of the Capper-Volstead Act should be construed as providing what it specifically does provide, viz.: That only persons engaged in the *production of agricultural products* may act together in a Capper-Volstead association to market the fruit *they grow* through such association; and that an association organized in part by members who are private profit-making corporations or individuals or partnerships that do not grow fruit is not organized in compliance with Sec. 1 of the Capper-Volstead Act.

Specifically as to Sunkist, Section 1 is not complied with by an association composed of only 80.12% fruit growers, 14.91% private profit-making corporations, individuals, and partnerships that do not grow oranges but purchase them and market them through Sunkist, and 4.97% profit-making corporations that admittedly do not qualify for Capper-Volstead protection. The legislative history shows that the Capper-Volstead Act was enacted for *farmer* organizations. *United States v. Maryland Milk Producers Assn.*, supra.

Surely the Capper-Volstead Act means what it says: That a cooperative's members must be growers, does it not?

Exchange Orange. Exchange Orange was a 100% owned private corporation whose stock was 100% owned by Sunkist. Hence it would fall with Sunkist.

Exchange Lemon. The make-up of defendant Exchange Lemon was the same as that of Sunkist (See

Capper-Volstead, Stipulation, C.T. 1791, et seq., particularly 1795:18-25). Thus, it is in the same position as Sunkist.

The Winckler Case. As stated supra, the District Court took the position that the Supreme Court in the *Winckler* case had ruled that Sunkist was organized in compliance with Sec. 1 of the Capper-Volstead Act. The District Court further apparently was of opinion that the decision of the Supreme Court was binding on the parties in this cause. At the March 2, 1964 hearing the Court declared, "I am not going into that issue in this case. I am going to rely upon the Winckler case" (R.T. 22A:21-23) and "Well, the Winckler case disposed of that issue entirely" (RT. 6A:1-2).

When plaintiff's counsel expostulated that plaintiff "spent hours and hours briefing the point" (R.T. 25A:14-15), the Court stated, "I don't know how it came up now and how the issue was raised, but I am going to rule that they have complied." (R.T. 45A:16-18). The Court so ruled despite the fact that plaintiff was not a party to the *Winckler* case and despite the fact that *Winckler* did not challenge Sunkist's compliance with the Capper-Volstead Act but conceded that Sunkist was a cooperative.

We realize that this Court is well aware that as plaintiff was not a party to the *Winckler* case that case is not *binding* on plaintiff. But inasmuch as this apparently was the trial Court's position; and inasmuch as Sunkist eagerly adopted this position "in almost the Court's language" when queried by the

trial judge (R.T. 24A:6-11), we present the following points with respect to the *Winckler* case:

First: The Supreme Court's grant of certiorari was premised on *Winckler's concession* that Sunkist, Exchange Orange and Exchange Lemon were cooperatives and that the issue was limited to whether these parties, *as cooperatives,* could be guilty of conspiracy under the Sherman Act in agreeing among themselves in the marketing and processing of their fruit. The grant of certiorari could not be clearer on this:

> "Petition for writ of certiorari to the United States Court of Appeals for the Ninth Circuit granted limited to Question 1 presented by the petition which reads as follows:
>
> "1. Where a group of citrus fruit growers form a cooperative organization for the purpose of collectively processing and marketing their fruit, and carry out those functions through the agency of three cooperative agricultural associations, each of which is basically wholly owned and governed by those growers, *and each of which is admittedly entitled to the exemption from the antitrust laws accorded to agricultural cooperatives by the Capper-Volstead Act* (7 U.S.C. sec. 291)—is an unlawful conspiracy, combination or agreement established under Sections 1 and 2 of the Sherman Act (15 U.S.C. § 1, 2) upon proof only that these growers, through the agency of these three cooperatives, *agreed among only themselves* with respect to the extent of the division of the function of processing between them or with respect to the price they would charge in the open market for the fruit and the by-products thereof processed and marketed by them?" (Emphasis

supplied) *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products Co.*, 368 U.S. 813 (1961).

Second: The limited question decided by the Supreme Court was whether or not the trial court's instruction, that Sunkist, Exchange Orange and Exchange Lemon, albeit cooperatives, could be guilty of conspiracy under Sec. 1 of the Sherman Act by agreeing amongst themselves to acts authorized by the Capper-Volstead Act was erroneous. This is most clear by the Supreme Court's opinion.

Third: And perhaps of most importance—the record made by plaintiff in the instant case, as above mentioned, showed that about 20% of Sunkist citrus packing house members were private profit-making corporations, individuals and partnerships most of whom did not grow the oranges they marketed through Sunkist, and none of whom qualified for the protection of the Capper-Volstead Act. It appears that no such record was made in the *Winckler* case. To the contrary, in pages 5-6 of Sunkist's opening brief to the Supreme Court filed February 7, 1962 in the *Winkler* case it is indicated that Sunkist handled only fruit of "Sunkist grower-members" that were organized into local associations:

> "About 12,000 individual growers of citrus fruit in the states of California and Arizona, whose average productive holding is about 16 acres each, have joined together for the purpose of 'collectively processing, preparing for market, handling and marketing' their fruit and its by-products . . . that organization over the years has evolved

into and has taken the form of three non-profit agricultural cooperative corporations (Growers, E.O.P. and E.L.P.)[5] which are the agencies to whom have been delegated the processing and marketing functions necessary to get the grower-members fruit and fruit products to market. *Each of these corporate entities handles only the fruit of Sunkist grower-members* . . . Each of them complies in all respects with the organizational and other conditions prescribed by the Capper-Volstead Act for immunity from the sanctions of the antitrust laws in respect of such collective processing, handling and marketing of agricultural products. Indeed, that they do so comply was conceded below by all concerned . . .

"This agricultural cooperative organization was referred to below as the Sunkist System. That term was used to mean not merely the one corporate entity called Sunkist Growers, Inc. but the entire organization—from the grower up through his intermediate associations . . . to the three corporate entities (Growers, E.O.P., and E.L.P.) into which the growers are organized that exists for the purpose of processing and marketing the products of its grower-members. It included also the functions of processing and marketing carried on by the various components of that organization . . . Sunkist is an organization, everyone agreed below, substantially the same as other marketing organizations organized under the Capper-Volstead Act . . .

"*At the base of the Sunkist system are* the *individual growers. It is their fruit, and only their*

[5] "Growers", refers to defendant Sunkist Growers, Inc., E.O.P. and E.L.P. refer to Exchange Orange and Exchange Lemon.

> *fruit, that is handled by Sunkist.* It is they who control and manage all components of the Sunkist cooperative organization. *The individual growers have organized into local associations.* The local associations, in turn organized into twenty-two district exchanges each of which is governed by a board composed of grower-member representatives of the local associations included in it. Each district exchange selects one grower-member to be its representative on the governing board of Sunkist Growers, Inc. All representatives serve without compensation." (Our emphasis)

More succinctly, Sunkist on page 24 of its brief represented:

> "It is still the underlying farmers who are combining; *it is only their products that are being processed and marketed; it is only their instrumentalities, controlled and managed by them,* that are doing the processing and marketing." (p. 24; our emphasis.)

The respondent Winckler did not challenge Sunkist's description of the Sunkist system. To the contrary, on page 7 of his brief Winckler stated (filed March 7, 1962):

> "With a few additions deemed essential to an adequate factual presentation, respondents accept petitioner's description of the organization and functions of the constituent elements of the so-called Sunkist system of cooperatives."

It appears that the Supreme Court in the *Winckler* case accepted this record as indicating that *all* Sunkist packing house members were grower associations:

"Sunkist Growers, Inc., has at its base 12,000 growers of citrus fruits in California and Arizona. *These growers are organized into local associations which operate packing houses.*" (Emphasis supplied) (370 U.S. at p. 21)

"In sum, *the individual growers involved each belong to a local grower association.*" (Emphasis supplied) (370 U.S. at p. 22).

That was according to the record made in *that* case; but on the stipulated record in *this* case, Sunkist was *not* organized in compliance with the provision of Sec. 1 of the Capper-Volstead Act and hence is not entitled to any immunity such act may afford.

II. THE DISTRICT COURT GROSSLY ABUSED ITS DISCRETION IN DENYING PLAINTIFF'S MOTION TO FILE A SECOND SUPPLEMENTAL COMPLAINT.

The Second Supplemental Complaint alleged facts occurring since the filing of the original complaint and fell squarely within the provisions of Rule 15(d), *Federal Rules of Civil Procedure.*

Defendant literally had years of notice. The pleading was designed to terminate the lengthy litigation by an award of damages suffered to the period ending 1/31/64 and for injunctive relief thereafter (C.T. 1283 et seq., 1786 et seq.).

Rule 15(d) contemplates leave to file supplemental pleadings as a matter of course under such circumstances and denial of leave constitutes an abuse of discretion. *New Amsterdam Casualty Co. v. Waller,*

323 F. 2d 20 (4th Cir. 1963); *Cert. denied,* 376 U.S. 963 (1964); *McHenry v. Ford Motor Co.,* 269 F. 2d 18 (6th Cir. 1959). Particularly should this be so when in denying plaintiff's motion to file the supplemental complaint the court states as grounds: That an oral ruling from the bench is not binding until reduced to writing and signed by the court and there was no motion before the court to file a second supplemental complaint (C.T. 126A:15-18). The Court must have been aware of plaintiff's pending motion of March 2, 1964, never withdrawn, and his favorable pronouncements thereon on March 2, and May 18, 1964—else why his statement that an order is not final until reduced to writing and signed?

The Court apparently was expostulating on plaintiff's failure to file a written motion in the form as provided by the Court's local rules (C.T. 126A:1-14). Written notice was given as stated above, but more controlling: Procedural defects with respect to the application for leave to amend were waived when defendant failed to object to the application at the March 2, 1964 hearing. *Arp v. United States,* 244 F. 2d 571 (10th Cir. 1957), *Cert. denied,* 355 U.S. 826 (1957); *Mutual Life Ins. Co. of New York v. Egeline,* 30 F. Supp. 738 (N.D. Cal. 1939); 60 C.J.S. p. 15, sec. 12; p. 21, sec. 19. Moreover, Rule 7(b) F.R.C.P. specifically provides for making an oral motion in open court.

The Court also stated that the second supplemental complaint brought in new issues (C.T. 134A:18-22). We believe a reading of the complaint, the supple-

nental complaint and the proposed second supplemental will dispel this as a possible valid ground for denying leave to file the second supplemental complaint. The supplemental pleadings in substance allege continuing wrongful use of a continuing monopoly power and continuing attempt to monopolize. The only change in complexion of the cause was introduced in the supplemental complaint (permitted by another judge) when Exchange Orange and Exchange Lemon merged into Sunkist. This permitted more effective abuse of monopoly power (See defendant's answer to Interr. 14, Plf's 3rd Supp. Interr. C.T., unnumbered page following p. 1706).

Supplemental pleadings to terminate involved and costly proceedings in one trial have been held proper even after proceedings have been remanded after appeal for further proceedings. *City of Texarkana v. Arkansas Gas Co.,* 306 U.S. 188 (1939).

The aggravated circumstances of the Court's denial (where plaintiff had to re-prepare its exhibits during trial), speak for themselves.

Nothing was gained by the lower Court's ruling but inviting continuing lawsuits embracing the precise issues of the instant cause.

If the cause is reversed, plaintiff should be permitted to file a second supplemental complaint alleging facts occurring since the filing of the supplemental complaint to date of new trial.

IV. THE TRIAL JUDGE DISPLAYED SUCH MARKED PREJUDICE AND BIAS AGAINST PLAINTIFF THAT IF THE JUDGMENT IS REVERSED TRIAL OF THE CAUSE SHOULD BE HELD BEFORE ANOTHER JUDGE.

Plaintiff is of course aware of the provisions of 28 U.S.C. Sec. 144 providing for the filing of an affidavit in the District Court for disqualification of a district Court judge. In this cause, however, the bias of the trial judge was his unwarranted prejudgment of the merits of the case as demonstrated in the trial of the case. The provisions of 28 U.S.C. Sec. 144 are not applicable to such situation. As stated by the Court in *Knapp v. Kinsey,* 235 F. 2d 129, at 131 (6th Cir. 1956) *Cert. denied* 352 U.S. 892 (1956), on petition for rehearing of the Court's decision in 232 F. 2d 458:

> "under the circumstances [where bias demonstrated in trial] the remedy can not be by a change of judges during the trial; it necessarily becomes a matter of alleged prejudicial error and for correction by the Court of Appeals."

When bias at the trial is demonstrated, the appellate court upon reversal will order the new trial before another judge. *United States v. Drumm,* 329 F. 2d 109 (1st Cir. 1964); *Knapp v. Kinsey,* 232 F. 2d 458; *Crowe v. DiManno,* 225 F. 2d 652 (1st Cir. 1955).

The conduct of the trial judge in the instant case falls squarely within the holding of the Court in the *Kinsey* case, 232 F. 2d at p. 466. The Court there ruled that "when the remarks of the judge during the course of a trial, or his manner of handling the trial, clearly indicate a hostility to one of the parties, or an

unwarranted prejudgment of the merits of the case, or an alignment on the part of the Court with one of the parties for the purpose of furthering or supporting the contentions of such party, the judge indicates, whether consciously or not, a personal bias and prejudice which renders invalid any resulting judgment in favor of the party so favored." See also *Crowe v. DiManno, supra.*

The Supreme Court in *Continental Oil Co. v. Union Carbide and Carbon Corp.,* supra, ruled that a district Court, in determining whether a plaintiff's evidence shows violation of the Sherman Act, may not scrutinize each component separately and wipe the slate clean. But that is precisely what the trial Court in this case did to the evidence of plaintiff's witnesses as such evidence was in the process of being adduced. The trial judge by his leading questions to the witnesses emphatically indicated to the jury that the witnesses testimony was insufficient to show wrongdoing by Sunkist; or the Court would disparage the testimony. This, together with his statements upon sustaining defendant's objections to plaintiff's questions, showed that the judge had prejudged the cause adversely to plaintiff. It goes without saying that the "whole" record must be examined to get the "whole" picture. But following are examples. We briefly state the point of the witnesses' testimony followed by quotation of a pertinent part of the Court's participation.

Morgan Ward. Testimony of principal witness on Sunkist price control:

"The Court: You say you followed the Sunkist price. That was voluntary on your part, wasn't it? . . . You weren't forced by Sunkist to follow the price were you? . . . You didn't think the Sunkist price was excessive as far as you were concerned? . . . One other question. You were not forced in any way to follow the Sunkist price? . . ." (R.T. 338:15 to 339:7).

W. K. McCracken. Sunkist limiting of orange supplies:

"The Court: And you knew that Sunkist had a priority on its own fruit. . . . And you knew that when Sunkist used its own fruit, that the only fruit available to other processors was fruit that Sunkist could not use, isn't that right?" (R.T. 723:5-19).

Robert Buchheim. Testimony of high prices and price control under Sunkist sale of Valencia oranges by bid system:

"The Court: When oranges were put up for bid, you were never excluded, were you?" (R.T. 337:24 to 339:22);

Testimony of limiting of orange supply. No ground of objection:

"The Court: Sustained. I don't think that is an issue in this case, whether they could use more oranges or not." (R.T. 344:1-25).

Testimony that Sunkist prevented TreeSweet from fulfilling commitment of oranges to plaintiff:

"The Court: You continued with your commitments to Case-Swayne didn't you, after this conversation?"

The witness did not oblige the Court and testified *no* (R.T. 355:25 to 357:7).

Carl Warnick, C.P.A., who testified as to figures showing that when Sunkist had the least amount of fruit it had the highest income per ton (R.T. 625) and also highest total income (R.T. 629:5-21, Plf's Ex. 97A):

> "The Court: Is there anything strange in that? . . . When there is more fruit there is a lower market, that is true isn't it? That is your experience, isn't it? . . . You say your speciality is cost accounting, is that right? . . . Isn't it true that in cost accounting you have found in any industry, regardless of what it is, that where there is a large amount of product, the price is low, and when there is a short amount of product, the price is high?" (R.T. 625:5-626:1).

F. R. Wilcox. On defendant's objection to question of whether Sunkist used consignment contracts to decrease oranges available to independent manufacturers: Ground of objection "argumentative":

> "The Court: Sustained. It assumes a fact that is not in evidence. The fact in evidence is that Sunkist preferred to process its own fruit." (R.T. 1097:17-24).

Testimony of increased orange production after Sunkist had stopped orange sales in 1958:

> "The Court: If the groves are five years or less old, you don't have additional product to amount to anything." (R.T. 1186:17 to 1187:19).

Amos Swayne. Testimony of why plaintiff did not bid for oranges:

"The Court: I don't think counsel should argue the case to the jury in this particular way.

Mr. Beardsley: I don't think so either . . .

The Court: You could have bid . . . [and when testimony was Sunkist rejected all bids]

Well, I don't know . . . this might be the first offer on a new crop. . . . Maybe Sunkist didn't want to accept." (R.T. 582:10 to 585:6).

Sunkist stopping sales of oranges:

"The Court: He wasn't just picking you out, he was just picking the industry out, is that it . . ." (R.T. 642:25 to 644:3).

Rufus Horne. Whether Hyland-Stanford could obtain sufficient oranges to operate profitably. Defendant objected on the ground it was a "conclusion":

"The Court: . . . whether or not he made a profit is immaterial" (R.T. 526:16-19).

We also mention the circumstances of the rulings of the trial judge that Sunkist, Exchange Orange and Exchange Lemon had complied with Section 1 of the Capper-Volstead Act and denying plaintiff's motion to file a second supplemental complaint. "Adverse rulings during the course of the proceedings are not by themselves sufficient to establish bias and prejudice". *Knapp v. Kinsey*, 232 F. 2d at p. 466. But the judge's precipitous adverse ruling on the Capper-Volstead issue without reading and before accepting and filing the stipulation of the parties was a particularly illuminating indication of bias—without regard to whether or not such ruling was erroneous. This issue would have been for the jury save for the

stipulation. *Beacon Theatres, Inc. v. Westover,* 359 U.S. 500 (1959). Sunkist would have had the burden of establishing its compliance with the Capper-Volstead Act by a preponderance of evidence. Yet the trial judge ruled on this issue *sua sponte.* His order on the Capper-Volstead issue (April 22, 1964, C.T. 307-10) was entered five months before he accepted and filed the stipulation (Oct. 27, 1964, C.T. 1790). The stipulation alone vested the Court with jurisdiction to decide the Capper-Volstead issue under the stipulated facts. But the judge decided the issue on the opinion of the Supreme Court in the *Winckler* case. Sunkist could hardly have used the *Winckler* opinion as evidence of its compliance with Section 1 of the Capper-Volstead Act.

Further, the Court's ground for denial of the plaintiff's motion to file a second supplemental complaint, that no motion was pending, was contradicted by the record. It is even indicated that counsel's failure to associate local counsel, even though plaintiff's counsel were both admitted to practice before the Court (R.T. 27A:1-12), might have played a part in such ruling (R.T. 126A:1-14).

It is perhaps human nature for bias, albeit unconscious, to induce adverse rulings, whether such rulings be erroneous or correct. That is more reason that a trial should be before a judge that has not pre-judged the cause.

Plaintiff respectfully submits that this Court should reverse the judgment of the trial Court and that the Court should further order:

(a) that the lower Court's ruling that Sunkist, Exchange Orange and Exchange Lemon had complied with Section 1 of the Capper-Volstead Act was erroneous, and that these parties had not complied with Section 1 of the Act and were not entitled to any immunity from the antitrust laws that the Act may afford;

(b) that the lower Court abused its discretion in denying plaintiff's motion to file a second supplemental complaint and that plaintiff be permitted to file supplemental pleadings setting forth occurrences since the date of the supplemental complaint to the date of the new trial;

(c) that the cause be remanded for immediate trial before another judge.

Dated, San Francisco, California,
October 22, 1965.

J. Edward Johnson,
W. Glenn Harmon,
William H. Henderson,
By W. Glenn Harmon,
Attorneys for Appellant.

Certificate of Attorney Responsible for Preparation of Brief

I certify that, in connection with the preparation of his brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

W. Glenn Harmon
Attorney for Appellant.

(Appendices A and B Follow)

Appendix A

LIST OF PLAINTIFF'S EXHIBITS

References are to pages in Reporter's Transcript

Number	For Id.	Offered	Received	Rejected
1	82	1210	1210	
1A	82	1132	1132	
2	82	1211	1211	
7A, 7AT		1192	1192	
8, 8T	82	644	644	
9, 9T	82	1133	1133	
9D, 9DT	82	983	983	
9E, 9ET	82	983	983	
9F, 9FT		983	983	
9G	82	983	983	
9GT	82	1071	1071	
10, 10T	82	1078	1078	
10A, 10AT	82	1078	1078	
10B, 10BT	82	1078	1078	
10C, 10CT	82	1080	1080	
11, 11T	82		496	
11A	82		496	
11C	82		496	
11T	82		496	
12	82		496	
12A	82		496	
12B	82		496	
13	82		496	
13A	82		496	
13B	82		496	
13C	82		496	
13Cp3	587	587	587	
13D	82		496	
14, 14T	82		496	
15	82	737	737	747

Number	For Id.	Offered	Received	Rejected
15T	82	737	737	747
18, 18T	82	967	967	
20, 20T	82	1022	1022	
21, 21T	82	1026	1026	
22, 22T	82	1026	1026	
23, 23T	82	1126	1127	
24, 24T	82	1026	1026	
25, 25T	82	1026	1026	
27	82	1210	1210	
28, 28T	82	1035	1035	
29, 29T	82	1034	1034	
30, 30T	82	1034	1034	
31, 31T	82	1034	1034	
32	82	1211	1212	
33	82	1212	1212	
34, 34T	82	971	971	
35, 35T	82	1045	1046	
36, 36T	82	1045	1046	
37, 37T	82	1045	1046	
38, 38T	82	1045	1046	
39, 39T	82	1045	1046	
40, 40T	82	1045	1046	
42, 42T	82	1045	1046	
43	82	1212	1213	
45	82	1212	1213	
46, 46T	82	1045	1046	
47, 47T	82	1045	1046	
52	82	554	554	
53	82	1088	1088	
54	82	1088	1088	
71	82	1099	1099	
72	82	1099	1099	
73	82	1099	1099	
74	82	1099	1099	
75	82	1099	1099	
88, 88T	82	667	667	
92, 92T	82	461	461	

Number	For Id.	Offered	Received	Rejected
93	82	1213	1213	
97, 97T	609		626	
97A, 97AT	609		621	
97B, 97BT	610	610	610	
97C, 97CT	609	619	620	
102, 102T	649	649	649	
102A, 102AT		649	649	
103, 103T	82	1115	1115	
104, 104T	233	609	609	
106, 106T	82	1124	1124	
108, 108T	82	1099	1100	
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114, 114T	233	379	379	
115, 115T	159	160	160	
116, 116T	168	168	168	
117, 117T	481	481		483
118, 118T	535	535	536	
121	539	994	999	
124A, 124AT	1189	1189	1190	
125	472	487	487	
126, 126T	615	615	615	
127	714	714		715
128	714	714		715
129	553	553		553
130, 130T	765	765	765	
131, 131T	768	777	777	
132, 132T	790	791	791	
133, 133T	1059	1060	1060	
143, 143T	1000	1001	1001	
144, 144T	1194	1194	1195	
146, 146T	1095	1095	1095	
147, 147T	1202	1202	1202	
148	1198	1198	1198	
149	1198	1198	1198	
150, 150T	1199	1199	1199	
151, 151T	1199	1999	1200	
152, 152T	1195	1200	1200	

Appendix B

LIST OF DEFENDANT'S EXHIBITS

Referenees are to pages in Reporter's Transcript

Number	For Id.	Offered	Received	Rejected
(All Deft's Exhs. preceded by letters SK)				
SK 70, 70T			896	
71, 71T			894	
72, 72T			901	
75, 75T			903	
78, 78T			908	
90, 90T			913	
149, 149T			887	
178			410	
179			409	
181			407	
182			408	
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183T			410	
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190T			417	
202		423		
203		424		
205		428		
206		429		
207		429		
208		430		
209		804		
209A		810		
210		847	851	
210T, pp. 142			851	
211		848	851	
211T			851	
212, 212T		859	859	
212A, 212AT		861	861	

No. 20069

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LOZANO ENTERPRISES,

Petitioner,

v.

NATIONAL LABOR RELATIONS BOARD,

Respondent.

On Petition to Set Aside Decision and Order of the National Labor Relations Board

---

PETITIONER'S REPLY BRIEF

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TABLE OF AUTHORITIES CITED

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PETITIONER'S REPLY BRIEF

I

THE EVIDENCE RELIED UPON BY THE BOARD THAT MARTINEZ WAS UNLAWFULLY LAID OFF IS INSUBSTANTIAL AND DOES NOT SUPPORT THE BOARD'S CONCLUSION.

At pages 5-7 of Petitioner's Opening Brief, cases were cited from the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and District of Columbia Circuits, all clearly establishing that the Board's Decision in this case is contrary to the evidence and is not supported by substantial evidence considering the record as a whole.

The Board has failed wholly to meet these cases and, instead, has sought to ignore them by saying that they are of "no aid" in resolving the present case. (Board's Br., p. 7.) Considering that the cited cases from so many circuits are adverse to the Board in the present case, it is understandable that the Board would like to ignore them--and an analysis of the cases shows why:

Second Circuit:

In Bon-R Reproductions, Inc. v. NLRB, 309 F.2d 898 (2 Cir.1962), there was evidence that the discharged employee admitted to his employer that he was responsible for the union's presence (309 F.2d at 901-02) and the court sustained the Board's conclusion that the employer violated Section 8(a)(1) of the Act by threatening his employees (309 F.2d at 903). However, the court reversed the Board's conclusion that the employee was discriminatorily discharged and rejected, as a basis for showing discrimination, certain ambiguous remarks made by the employer (309 F.2d at 906-07):

> "In our judgment, to hang so much on the slim peg of a few ambiguous sentences is to allow an excerpt of the record to swallow up the whole, something which Universal Camera, supra, forbids. Without giving controlling effect to any one element, we think that the facts surrounding

Scrima's discharge, coupled with the examiner's finding on credibility, make up a record which permits only one conclusion. In the light of this record, any other conclusion would amount to a decision, supported neither by reason nor the statute, that even the least improper remarks made in the course of discharging an employee render the discharge an unfair labor practice."

The Board in the present case, as in the Bon-R Reproductions case, is hanging its conclusion that Martinez was discriminated against on "the slim peg of a few ambiguous sentences." For example, the Board complains (Board's Br., p. 3) that Laguna told Juan Baltierra that Ocariz had some "infernal machinations," that Ocariz was nobody there at the plant, and that Baltierra, by paying attention to Ocariz, would go down in rank. None of these statements in any way referred to the Union.

Likewise, the Board complains that, when Martinez admitted that he was still a member of the Union, Laguna replied "You know best." (Board's Br., p. 4.) Certainly, this remark shows no animosity; to the contrary, it shows a complete hands-off policy.

Fourth Circuit:

In NLRB v. Threads, Incorporated, 308 F.2d 1,

11-13 (4 Cir.1962), Bell was a known union adherent who did bad work on several occasions and also violated company rules. He was reprimanded but not disciplined for these lapses. Finally, following an absence from his machine, he was discharged. The Board determined that Bell was discriminatorily discharged, saying (308 F.2d at 12-13) that the company's other unfair labor practices furnished a sufficient basis for a finding that the company "utilized Bell's absences from his machine as a pretext and that it discharged him because of his union adherence." In reversing the Board, the Fourth Circuit said (308 F.2d at 13):

> "Thus the Board undertook to impose a double standard as to the value of 'background evidence.' On the one hand, throughout its order, the Board emphasized all of the elaborately detailed background evidence which it considered to be adverse to the Company's position and favorable to the Union's position. But, on the other hand, when the Company showed that it had tolerated Bell's misconduct, carelessness and disobedience for a long time after learning of his union affiliation and adherence, the Board lightly dismissed all such evidence with the statement: '<u>The fact that Bell damaged property or committed</u>

derelictions on other earlier occasions is immaterial as the Respondent [Company] did not purport to discharge him for any such alleged misconduct.' (Emphasis supplied.)

"But, what is much more serious and disturbing, the Board has either overlooked or ignored the admonition of this court that there is no legal basis for finding that the assigned reason for a discharge is nothing but a 'pretext' where it is shown, as here, that prior misconduct of an employee was tolerated under circumstances which negate any idea that the employer was searching for some false reason to discharge the employee on account of his union activities. In Martel Mills Corp.v.National Labor Relations Board, 114 F.2d 624, 632 (4th Cir.1940), this court stated:

"'* * * Had the Martel Mills desired to discharge Whittle for his union affiliations, it could very easily have selected one of the occasions when Whittle had violated the company rul or one of the occasions when his fellow-workers complained of his actions. Instead, it allowed these complaints and disturbances to accumulate until a time when the record of the individual employee served as one of the bases for

maintaining or discharging him.'" (Emphasis the court's.)

In the present case, as in the Threads case, the Board seeks "to impose a double standard."

Despite the fact that the Trial Examiner and the Board found that:

1. Martinez let a stranger operate his linotype machine (TXD, pp. 4-5);
2. Martinez left the plant and left his machine running (ibid.);
3. Martinez came to the plant while off duty and drunk and tried to start a fight (ibid.);
4. Martinez marked a time card (ibid.);
5. Martinez parked his car in a space needed to load mail bags (ibid.);
6. Martinez' denials of misdeeds or reprimands were not to be credited (id., p. 5);
7. Martinez' denials were evasive in most instances (ibid.)
8. Martinez' testimony on the above instances reflect generally on his credibility as a witness (ibid.);
9. Martinez had more instances of objectionable conduct to his credit than the one employee junior to him (id., pp. 8-9),

the Trial Examiner and the Board then say that since

"In the eyes of Respondent the instances of misconduct, occurring over the three years of his employment, were not of such magnitude as to warrant discharge; in fact, it did not prejudice his recall to employment at the very first opening in February, 1964" (id., p. 9) and since "I find that Respondent has not seriously regarded Martinez' misdeeds" (id., p. 11), therefore Martinez was laid off because he failed and refused to abandon the Union (ibid.).

In its brief, the Board advances the same contentions. (Board's Br., p. 11.)

The "double standard" applied by the Board is clear. In the first place, the Company (as noted by the Trial Examiner and the Board, TXD, p. 5) has never contended that Martinez was discharged for cause, but merely that, when the Company was confronted with the necessity of having to lay off an employee, Martinez was selected because he was not as good an employee as the only employee junior to him. If the Company had been searching for a pretext to discharge Martinez because of his union activities, "it could very easily have selected one of the occasions when [Martinez] had violated the company rules or one of the occasions when his fellow-workers complained of his actions. Instead, it allowed these complaints and disturbances to accumulate until a time when the record of the individual employee served as one of the bases for

maintaining or discharging him." NLRB v. Threads, Incorporated, supra, 308 F.2d at 13.

In the second place, if the Company really wanted to get rid of Martinez because of his union activities, it is incomprehensible that Lozano would have promised to recall him at the very first opportunity, as found by the Board (TXD, p. 7), and that he was in fact recalled at the first opening, as found by the Board (Id., p. 9; p. 10).

> "If discrimination may be inferred from mere participation in union organization and activity followed by a discharge, that inference disappears when a reasonable explanation is presented to show that it was not a discharge for union membership."
>
> NLRB v. United Brass Works, Inc.,
> 287 F.2d 689, 693 (4 Cir.1961).

Fifth Circuit:

In NLRB v. Huber & Huber Motor Exp., 223 F.2d 748 (5 Cir.1955), there was evidence that the discharged employee had been obnoxious and aggressive in the performance of certain protected union activities. He also failed to comply with a company rule. In reversing the Board's determination that the employee had been dis-

criminatorily discharged and that the rule violation "was only a shadow, but opportune pretext" to screen the true motive for the discharge, the court said (223 F.2d at 749):

> ". . . [W]here the Board could as reasonably infer a proper collateral motive as an unlawful one, the act of management cannot be set aside by the Board as being improperly motivated. National Labor Relations Board v. Houston Chronicle Publishing Company, 5 Cir., 211 F.2d 848. National Labor Relations Board v. Blue Bell Inc., 5 Cir., 220 F.2d.
>
> "Where a legal ground for discharge existed - as it did in this case - and the employee was discharged on that ground alone, obnoxious conduct on his part, in an activity protected by Section 7 of the Act, will not insulate him from being discharged on such legal ground."

In the present case, the Trial Examiner and the Board found that "it necessarily follows that to maintain this quota of employees in this department, one employee would have to be terminated to make a position available for Villasenor." (TXD, p. 3.)

Martinez testified that at the time of his lay-off,

Laguna told him that it was for discriminatory purposes (id., p. 6). This was denied by Laguna (ibid.). The Trial Examiner and the Board specifically discredited Martinez' version and credited Laguna's, and found no such "crucial" statement, indicating a discriminatory motive, was made by Laguna (ibid.). The Trial Examiner and the Board also discredited Martinez' testimony that Lozano told him that "other obligations" dictated the choice of Martinez for the lay-off (id., p. 7).

The Trial Examiner and the Board also found that Martinez had more instances of objectionable conduct to his credit than the one employee junior to him (id., pp. 8-9).

Thus, the sole ground given to Martinez in his notice of the lay-off, as found by the Trial Examiner and the Board, was the reinstatement of Villasenor. As in the Huber & Huber case (223 F.2d at 749), "the parties are not in dispute that the sole ground in the notice of discharge" was to make room for Villasenor and "where the Board could as reasonably infer a proper collateral motive as an unlawful one, the act of the management cannot be set aside by the Board as being improperly motivated."

The slim basis upon which the Trial Examiner and the Board found that Laguna was discriminatory against Martinez was Martinez' testimony that, upon occasion,

Laguna solicited Martinez to abandon the Union (TXD, pp. 7-8). The Trial Examiner and the Board did not credit Laguna's denials of these solicitations (id., p. 8).

At the same time, however, the Trial Examiner and the Board characterized other of Martinez' testimony as "evasive" (id., p. 5) and questioned his general credibility as a witness (ibid.). The Trial Examiner and the Board expressly discredited Martinez' testimony seven distinct times (id., p. 5, line 11; p. 5, lines 23-24; p. 5, line 35; p. 6, lines 34-38; p. 6, lines 41-42; p. 7, lines 21-22; p. 8, lines 31-32).

Further, the Trial Examiner and the Board say that the testimony of Martinez "to the solicitations to abandon the Union is supported by the credible testimony of Baltierra and Villasenor" (id., p. 8); however, the transcript may be searched in vain for any testimony by Baltierra or Villasenor that they ever heard any such solicitations by Laguna to Martinez.

In addition, the Trial Examiner and the Board expressly concluded that none of such solicitations constituted threats or promises or were independent 8(a)(1) violations (id., p. 7; p. 9; p. 10) and that Martinez was not laid off because of having testified at a prior hearing (id., p. 10; p. 11).

Further, the Trial Examiner and the Board found that Laguna even went so far in his friendship for

Martinez as to have his wife help Martinez' wife when she had a baby (id., p. 8); this is not consistent with an "animus" against Martinez.

Considering the Trial Examiner's and the Board's general discrediting of Martinez as a witness; their findings that no discriminatory statements were made at the time of Martinez' lay-off; their conclusions of no independent 8(a)(1) or 8(a)(4) violations; their finding that room had to be made for the return of Villasenor; their finding that Martinez was the most junior but one of the employees, but had more instances of objectionable conduct - considering all these factors, it is incredible that the Trial Examiner and the Board can, with a straight face, contend that there has been discrimination.

The situation is parallel to that in NLRB v. Florida Steel Corp., 308 F.2d 931, 935 (5 Cir.1962), where, in reversing the Board's finding of discrimination, the court was critical of the undue probative value given by the Trial Examiner and the Board to the testimony of a chief witness who, just as with Martinez in the present case, was specifically discredited by the Trial Examiner.

Sixth Circuit:

In NLRB v. Dixie Terminal Co., 210 F.2d 538 (6 Cir. 1954), employee Ross participated in union activities and also refused to take over the job of starter of a passenger elevator. The Board found that Ross was discharged

because of his union activities. In reversing the Board, the court said (210 F.2d at 540):

> "We are also of the opinion that the discharge of Ross was justified by Ross's refusal to accept his assignment of duty. The fact that he was participating in organizing the union does not prevent his discharge for cause. N.L.R.B. v. West Ohio Gas Co., 6 Cir., 172 F.2d 685, 688; N.L.R.B. v. Mylan-Sparta Co., 6 Cir., 166 F.2d 485, 491."

In the present case, Martinez, as found by the Trial Examiner and the Board, had more instances of objectionable conduct to his credit than the one employee junior to him; the fact that he was a union member does not prevent his being selected for lay-off in lieu of a better employee.

Seventh Circuit:

In NLRB v. Milwaukee Elec. Tool Corp., 237 F.2d 75 (7 Cir.1956), the discharged employee was an active union supporter and the company's president had testified that he felt that an employee who attempted to influence other employees to join the union by telling them they would have to join was engaged in sufficient disloyalty to warrant discharge. In reversing the Board's finding of

a discriminatory discharge, the court said (237 F.2d at 78):

> "As we read the Board's argument, studded with handpicked fragments of evidence, it collides with several pertinent propositions stated by Judge Lindley when delivering the majority opinion reported as N.L.R.B. v. Wagner Iron Works, 7 Cir., 1955, 220 F.2d 126, 133: 'Obviously, the Act does not interfere with the employer's right to conduct his business, and, in doing so, to select and discharge his employees. It proscribes the exercise of the right to hire and fire only when it is employed as a discriminatory device. [Citing.] The Board may not "substitute its judgment for that of the employer as to what is sufficient cause for discharge" [citing] and discrimination may not be inferred from an employee's mere membership in a union. [Citing.] * * *'
>
> "The utterances of Siebert are, on this record, insufficient to make the discharge of Stempniewski more than suspect, but not discriminatory. They fail, in our opinion, to support the Board's findings in this regard."

In the present case, in the light of the Trial Examiner's and the Board's findings that there were no independent 8(a)(1) or 8(a)(4) violations, that Martinez' testimony that discriminatory reasons were given to him for his lay-off could not be believed, that Martinez had more instances of objectionable conduct to his credit than the one employee junior to him, and that someone had to be laid off to make room for Villasenor, the Board's brief, referring as it does to such vague statements as "infernal machinations" and "You know best," presents an argument "studded with handpicked fragments of evidence" that, even considered in their worst light, are "insufficient to make [the lay-off of Martinez] more than suspect, but not discriminatory."

Eighth Circuit:

In NLRB v. Ace Comb Company, 342 F.2d 841 (8 Cir.1965), unlike the present case, it was found by the Board and sustained by the court that the company had engaged in independent threatening and coercive conduct. There was thus more evidence of anti-union animus than there is in the present case, where both the Trial Examiner and the Board have found no independent 8(a)(1) violations. However, the court reversed the Board's determination that the employee was discriminatorily discharged and, after reviewing the applicable general principles of law prescribed by the United States Supreme

Court, the Second, Third, Fifth, Sixth, Seventh, Eighth and Ninth Circuits (342 F.2d at 847-48), held (quoting from the Ninth Circuit) as follows, in words particularly in point to the present case (342 F.2d at 848):

> "In other words, here the evidence abounds that there was a justifiable cause for Woodliff's discharge. Assigning an illegal cause therefor is only possible by drawing an inference from certain vague statements on the part of management officials, while ignoring positive evidence arrayed against such inferences. 'Circumstances that merely raise a suspicion that an employer may be activated by unlawful motives are not sufficiently substantial to support a finding.' N.L.R.B. v. Citizen-News Co., 134 F.2d 970, 974 (9 Cir.1943). This being so, we cannot conscientiously hold that the record as a whole contains substantial evidence that the discharge of Woodliff was motivated by other than lawful business reasons."

In the present case, the evidence (and the findings of the Trial Examiner and the Board) abound that there was justifiable cause for Martinez' lay-off, including the necessity to lay off someone, Martinez' low seniority, and

the fact that the one more junior employee was a better employee. To assign an illegal cause for his lay-off "is only possible by drawing an inference from certain vague statements on the part of management officials, while ignoring positive evidence arrayed against such inferences."

Here, the Board seems to think it has support for its case in the fact that the Company discussed the lay-off with its attorney and was advised that the surest way to stay out of trouble was to follow strict seniority, but that the Company disregarded this advice. (Board's Br., p. 5-6.) This is just the sort of inference that is condemned in the Ace Comb case. If anything, the Company's seeking the advice of its attorney, being concerned about the discriminatory implications, and still selecting Martinez for the lay-off shows that the motive in picking Martinez was non-discriminatory.

Ninth Circuit:

One of the earliest cases involving the subject matter of the present case, and the case which is controlling here, is NLRB v. Citizen-News Co., 134 F.2d 970 (9 Cir.1943), where this Court reversed the Board's determination that a discharge was discriminatory, and in language directly in point to the present case where the evidence shows, and the Board has found, that Villasenor's return was a valid reason for the lay-off, that Martinez

was the most junior but one of the employees, and that that employee was a better employee, said (134 F.2d at 973-74):

> "In considering this question it should be emphasized that the right to terminate a contract of employment is a constitutional right of the utmost importance. The mere discharge of an employee with or without reason is therefore not evidence of intent to affect labor unions or the rights of employees under the National Labor Relations Act. . . . Circumstances that merely raise a suspicion that an employer may be activated by unlawful motives are not sufficiently substantial to support a finding.
>
> "The fact that a discharged employee may be engaged in labor union activities at the time of his discharge, taken alone, is no evidence at all of a discharge as the result of such activities There must be more than this to constitute substantial evidence."

In the present case, the Board apparently finds it "suspicious" that, shortly after one of the instances of his misconduct, Martinez was transferred to the night shift from the substitute position, thus getting a

wage premium (Board's Br., p. 11). The Board apparently infers that this was a "promotion" for Martinez, hence his misconduct was not regarded seriously by the Company, hence it could not have been a reason for his lay-off, hence the only remaining reason had to be discriminatory. This reasoning, however, ignores the explicit finding of the Trial Examiner and the Board that, whether or not Martinez' instances of misconduct were sufficiently serious to cause his discharge, they were at least more numerous than those of the only employee junior to him. It is wholly immaterial whether or not the misconduct was sufficiently serious to cause his discharge or to prevent his recall - the issue is not whether the Company had grounds for discharging Martinez for cause, but whether, when a lay-off (as distinguished from a discharge) was necessary, Martinez was as good an employee as the only one junior to him. Both the Trial Examiner and the Board have found that he was not, and it is irrelevant that the Company may have earlier tolerated his misconduct.

In any event, the transfer of Martinez from the substitute position to the night shift, with its wage premium for working at night, was in no way a "promotion." The uncontradicted evidence is that Martinez was put on the night shift because Barunda was made the substitute worker because he was "the more desirable employee to work alone without direct supervision" (TXD, p. 5).

On the other hand, if the night shift be considered an advancement, Martinez' "dues paying status with the Union did not interfere with his advancement" (id., p. 9), and it then becomes absurd to say, as does the Board, that because the Company "advanced" Martinez despite his union membership this proves that when he was laid off, it was because of his union membership. This is exactly the 180-degree swing criticized and rejected in NLRB v. Sebastopol Apple Growers Union, 269 F.2d 705, 713 (9 Cir. 1959), citing from NLRB v. McGahey, 233 F.2d 406, 412 (5 Cir.1956):

> "The Board's error is the frequent one in which the existence of the reasons stated by the employer as the basis for the discharge is evaluated in terms of its reasonableness. If the discharge was excessively harsh, if the lesser forms of discipline would have been adequate, if the discharged employee was more, or just as, capable as the one left to do the job, or the like then, the argument runs, the employer must not actually have been motivated by managerial considerations, and (here a full 180 degree swing is made) the stated reason thus dissipated as pretense, nought remains but antiunion purpose as the explanation. But as we have so often said:

management is for management. Neither Board nor Court can second-guess it or give it gentle guidance by over-the-shoulder supervision. Management can discharge for good cause, or bad cause, or no cause at all. It has, as the master of its own business affairs, complete freedom with but one specific, definite qualification: it may not discharge when the real motivating purpose is to do that which Section 8(a)(3) forbids.

District of Columbia Circuit:

The District of Columbia Circuit is in accord with all of the other cited Circuits.

In Metal Processors' Union Local No. 16, AFL-CIO v. NLRB, 337 F.2d 114 (DC Cir.1964), in sustaining the Board's determination that a discharge was not discriminatory despite the fact that the employee had engaged in union activities preceding his discharge, the court points out that there was no evidence to indicate company hostility toward the employee and that differences between the foreman and the employee were amicably worked out (337 F.2d at 117). This is parallel to the present case, where Martinez' wife helped the foreman Laguna's wife when she had a baby (TXD, p. 8), and where the so-called solicitations by Laguna to Martinez to leave the Union carried no hostility (Board's Br., p. 4), and where the Trial Examiner

and the Board specifically found no evidence of independent threats or coercion (TXD, p. 7), and where the Trial Examiner and the Board found that Martinez' advancement was not impeded by his Union membership (id., p. 9). As said in the Metal Processors' Union case (337 F.2d at 117)

> "The Union argues further that the Board erred in rejecting certain evidence which, it is said, established general Company hostility toward the Union, from which, in turn, it may be inferred that Zajac's discharge was discriminatory. With this we cannot agree. Even if it were assumed arguendo that the evidence referred to did establish general Company animosity toward the Union, it would be insufficient in itself to ground the inference that Zajac's discharge was violative of the Act. As the court in N.L.R.B. v. Redwing Carriers, Inc., 284 F.2d 397, 402 (5th Cir.1960), observed:
>
> "'The opposition of an employer to union organization and even unlawful interference are not enough without more to make the discharge of an employee wrongful. N.L.R.B. v. Hudson Pulp & Paper Corp., 5 Cir., 273 F.2d 660; N.L.R.B. v. McGahey, 5 Cir., 233 F.2d 406.'"

CONCLUSION

This is a case where the Board's decision, predicated solely upon a few ambiguous statements attributed to management or upon a few non-hostile solicitations to Martinez to leave the Union or upon some old statements made in 1961 in another case (Board's Br., pp. 3-4, pp. 8-9), finds discrimination. But the Board's decision is contrary to court decisions in the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and District of Columbia Circuits. It is grounded upon speculation and mere suspicion. It is contrary to its own findings as to the relative merit of Martinez compared to the only employee junior to him. It involves 180-degree swings, finding, as it does, that Martinez was advanced <u>despite</u> his union membership and then laid off <u>because of</u> it and then later re-called <u>despite it</u>. It discredits Martinez as a witness <u>seven</u> times, including his general credibility, and then gives undue probative value to his testimony that he was solicited to leave the Union.

This is a case where, unsupported by the evidence, and in fact contrary to its own findings on Martinez' comparative merit, the Board has determined that there was discrimination. But the mere fact that the Board says that there was discrimination does not make it so; the Board's determination cannot exist without the support of substantial evidence.

DATED: December 27, 1965.

Respectfully submitted,

SHEPPARD,MULLIN,RICHTER & HAMPTON
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Attorneys for Petitioner

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those Rules.

Frank Simpson

PROOF OF SERVICE

I, the undersigned, being first duly sworn, say that I am and was at all times herein mentioned a United States citizen and a Los Angeles, California, resident, over 18 years of age and not a party to the within action; that on 27 December 1965 I served the within Petitioner's Reply Brief on the below-named parties in said action, by depositing true copies thereof, enclosed in sealed envelopes with postage thereon fully prepaid, in a mail-box regularly maintained by the United States Government at Los Angeles, California, addressed as follows:

National Labor Relations Board (3 copies)
Washington 25, D.C.

General Counsel, National Labor Relations Board, Region 21
849 South Broadway, Los Angeles, California 90014

James R. Webster, Esquire, Trial Examiner
National Labor Relations Board
Federal Building
450 Golden Gate Avenue
San Francisco, California

E. M. Dorsey

Subscribed and sworn to
before me 27 December 1965.

Shirley Schuster

Notary Public, California
Principal office, Los Angeles
County

OFFICIAL SEAL
SHIRLEY SCHUSTER
NOTARY PUBLIC - CALIFORNIA
PRINCIPAL OFFICE IN
LOS ANGELES COUNTY

No. 20069

In the United States Court of Appeals for the Ninth Circuit

LOZANO ENTERPRISES, PETITIONER

v.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

On Petition to Review and Set Aside and on Cross-Petition for Enforcement of an Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

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BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court upon a petition to review an order of the National Labor Relations Board (R. 74-75, 64-66),[1] issued against petitioner

[1] References to the pleadings, the decision and order of the Board, and other papers, reproduced as "Volume I, Pleadings," are designated "R." References to the stenographic transcript of record reproduced pursuant to Court Rules 10 and 17 are designated "Tr." References preceding a semicolon are to the Board's findings; those following are to the supporting evidence.

on January 26, 1965, following proceedings under Section 10 of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, *et seq.*).[2] In its answer the Board requests enforcement of its order.

The Board's decision and order are reported at 150 NLRB No. 123. This Court has jurisdiction of the proceedings under Section 10(e) and (f) of the Act, the unfair labor practice having occurred at petitioner's place of business in Los Angeles, California.

COUNTERSTATEMENT OF THE CASE

Briefly, the Board found that petitioner violated Section 8(a)(3) and (1) of the Act by discharging employee Javier Martinez because of his union membership. The evidence on which this finding rests may be summarized as follows:

A. Foreman Laguna's dislike of the Union and his attempts to persuade Martinez to leave it

Petitioner is engaged in the publication, sale and distribution of *La Opinion*, a daily newspaper in the Spanish language (R. 54). Andres Laguna is in charge of its Linotype Department and in that position directs the work of the linotype operators, assigns overtime work and assigns shifts to employees in that department (R. 55-56; Tr. 148-150, 156-158, 310, 362).[3]

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[2] The pertinent provisions of the Act are set forth, *infra*, pp. 14-15.

[3] Laguna has also hired at least one employee (R. 56; Tr. 17-18).

Laguna has been strongly opposed to the Union [4] ever since its initial organizing campaign at petitioner's plant. See, *N.L.R.B.* v. *Lozano Enterprises*, 318 F. 2d 41, 42 (C.A. 9). Between April and November of 1961, Laguna had several conversations with employee Villasenor during which he told the latter not to join the Union because the employees would only be exploited. Laguna also told Villasenor that if he would leave the Union his salary would be raised to $2.50 per hour (R. 60; 318 F. 2d 41). Villasenor was discharged because he refused to abandon the Union. *Lozano Enterprises, supra.*[5]

In November 1963, Laguna told employee Juan Baltierra that Ocariz had some "infernal machinations," that Ocariz was nobody there at the plant, and that Baltierra, by paying attention to Ocariz, would go down in rank (R. 60; Tr. 119). Ocariz is an employee at petitioner's plant. He serves as chairman for the Union and collects the dues from petitioner's union members (R. 60; Tr. 119-120). Baltierra was a dues-paying member of the Union (R. 60; 120). In January 1964, Laguna told the newly-reinstated Villasenor that "if you yourself recognize that you work here and you live from what you earn here, you should be with the company" (R. 60; Tr. 160-162).

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[4] Los Angeles Typographical Union No. 174, affiliated with International Typographical Union, AFL-CIO.

[5] At the time of Villasenor's discharge, Laguna told a fellow employee: "Last Wednesday I fired Villasenor because in the office they don't want him here because he is one of the union leaders." *Lozano Enterprises, supra,* 318 F. 2d at 42.

Laguna also sought on several occasions to persuade employee Javier Martinez to leave the Union. In October 1962, Laguna told Martinez, "Javier, make up your mind to leave the union alone. Your future is here with us, with the firm. I can give you a lot of overtime just like I do with those that are on our side" (R. 60; Tr. 23-24). When Martinez replied that he was "with the other workers" (Tr. 24) Laguna told him, "Sooner or later you will change your mind" (Tr. 24). Later in that same year, Laguna told Martinez, "Javier, I notice that you have not made up your mind to leave the union. I see that you are still paying your dues" (R. 61; Tr. 25). Martinez admitted that he was still a member of the Union and Laguna replied, "You know best" (R. 61; Tr. 26). In March 1963, Laguna again told Martinez that he should leave the Union alone and that his future lay on the side of the Enterprise (R. 61; Tr. 285-287, 100).

B. Martinez is discharged

On June 8, 1963, this Court enforced an order of the Board requiring petitioner to reinstate former linotype operator Jose Villasenor, who had been discriminatorily discharged because of his adherence to the Union. *N.L.R.B.* v. *Lozano Enterprises*, 318 F. 2d 41, enforcing 137 NLRB 128. Petitioner customarily employs four linotype operators on its night shift, three on the day shift, and one who works weekends as well as substitutes for the regular linotypists (R. 56; Tr. 329). All these positions were filled at the time this Court ordered the reinstatement of Villa-

senor (R. 56; Tr. 368). Therefore, in order to comply with the Court's decree petitioner decided to terminate one of the linotype operators then in its employ (R. 56; Tr. 368).

Jesus Barunda, the substitute worker, had the least seniority among the linotypers, having been in petitioner's employ for only ten months (R. 56, 63; 369-370, 325). Arturo Duenas was next in point of least continuous service with the Company, having been employed to replace Villasenor in 1961. However, Duenas had previously been in the employ of petitioner from the latter part of the 1920's to 1957 (R. 56-57; 373, 390). The third lowest man in terms of seniority was Javier Martinez, who had been with the company since August of 1960 (R. 56; 8). Neither Barunda nor Duenas was a dues-paying member of the Union. Barunda had never joined the Union, and Duenas had discontinued paying his dues (R. 56; Tr. 199-200). Martinez, however, was a union member and, as detailed above, he had always rebuffed Laguna's attempts to get him to abandon the Union (*supra*, p. 4).

Martinez had been promoted from the position of substitute worker to full-time employment on the night shift in January 1963 (R. 63; Tr. 291, 329). The latter position carried with it a wage premium (R. 57; Tr. 406-407). Martinez was chosen for the regular, night position over Barunda, who was in petitioner's employ at the time (R. 58, 63; Tr. 369-70, 325).

Petitioner's attorney advised that the surest way to keep out of trouble in determining whom to discharge

to make room for Villasenor was to follow strict seniority (Tr. 366-367, 289-290). However, at a conference between Laguna, Publisher Lozano and General Manager Bravo, it was decided to terminate Martinez rather than Barunda, although the latter was the man with lowest seniority (R. 58; 372). This decision was reached primarily on the recommendation of Laguna (R. 58, 63; 370-372). On August 10, 1963, Martinez was discharged (R. 64; 10, 12).

THE BOARD'S CONCLUSIONS AND ORDER

On the basis of the foregoing, the Board found that petitioner violated Section 8(a)(3) and (1) of the Act by selecting employee Javier Martinez for discharge because of his refusal to abandon the Union. Accordingly, the Board's order requires petitioner to cease and desist from the unfair labor practice found and from in any other manner impinging on employees' rights guaranteed by the Act. Affirmatively, the order requires petitioner to offer reinstatement to employee Martinez, to repay him, with interest, for his loss of wages resulting from the discrimination against him, and to post the customary notices (R. 64-67).

ARGUMENT

Substantial Evidence on the Record Considered As a Whole Supports the Board's Finding That Petitioner Violated Section 8(a)(3) and (1) of the Act by Discharging Employee Martinez Because of His Union Membership

The sole question before this Court is a factual one —whether employee Martinez was discharged because

of his union adherence or because of his relative inferiority when compared with a fellow employee. Citation of cases in which the factual basis for a Board finding was insufficient (pet. br. pp. 5-7) is of no more aid in resolving this issue than would be citation of the numerous cases in which the Board finding was held to be supported by the record. Similarly unhelpful is the recitation (pet. br. p. 7) of the truism that mere membership in a union does not shield an employee from discharge for cause. It is equally true that the "existence of some justifiable ground for discharge is no defense if it was not the moving cause." *Wells, Inc.* v. *N.L.R.B.*, 162 F. 2d 457, 459-60 (C.A. 9); *N.L.R.B.* v. *Texas Independent Oil Co.*, 232 F. 2d 447, 450 (C.A. 9). See also, *N.L.R.B.* v. *Symons Mfg. Co.*, 328 F. 2d 835, 837 (C.A. 7).

What is relevant, although absent from petitioner's brief, is an analysis of the factual support in the record for the Board's finding in this case. As we demonstrate below, there is substantial evidence on the record as a whole to support the Board's finding that Martinez was selected for termination because of his unshakable adherence to the Union and that whether or not his conduct was inferior to another employee's, that inferiority was put forward by petitioner only to mask its illegal motives.

This record amply demonstrates that petitioner, and especially its supervisor, Laguna, has had a long and abiding dislike for the Union and the participation therein of its employees. The discriminatory discharge of employee Villasenor, *N.L.R.B.* v. *Lozano*

Enterprises, 318 F. 2d 41 (C.A. 9), is, of course, a prime illustration of this antiunion attitude. In addition, antiunion statements and illegal promises of benefits were uttered by Laguna as early as April 1961, while the Union was in the process of organizing respondent's plant. In November 1963, Laguna referred to the activities of the Union chairman as "infernal machinations" (Tr. 119), and warned an employee that he would go down in rank if he paid attention to the Union. As recently as January 1964, Laguna's hostility to the Union once again manifested itself. He warned the newly-reinstated Villasenor, already the victim of a discriminatory discharge, that "if you yourself recognize that you work here and you live from what you earn here, you should be with the Company" (Tr. 161-162).

On numerous occasions Laguna sought to persuade the discriminatee, Martinez, to abandon the Union. He emphasized that Martinez should leave the Union alone because his future lay with the Company. On one occasion Laguna went so far as to promise Martinez that he would be favored with overtime work if he left the Union alone.[6] On these occasions Martinez

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[6] Petitioner has abandoned its objection to the fact that the Trial Examiner credited Martinez's account of this episode whereas he had discredited Martinez's testimony on other matters. In any event, it is well-settled that the question of credibility of witnesses is for the Trial Examiner. *N.L.R.B.* v. *Lozano Enterprises*, 318 F. 2d 41, 43 (C.A. 9); *N.L.R.B.* v. *State Center Warehouse and Cold Storage Co.*, 193 F. 2d 156, 157 (C.A. 9). Moreover, as this Court has only recently observed: "The rule that a witness may be totally disbelieved if he is found to have testified falsely in any respect is not a

always remained firmly in the Union camp, stating that he was "with the other workers" (Tr. 24). Given Martinez' known, firm prounion attitude, Laguna's dislike of the Union, and management's previous attempt to rid itself of a union adherent, the Board was justified in finding that illegal considerations motivated petitioner to depart from strict seniority criteria to dismiss Martinez.[7]

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command. Witnesses are frequently demonstrably in error in parts of their testimony, but nevertheless believed by the trier of fact in other respects. It is just such judgments that the trier of fact must make." *N.L.R.B.* v. *Lozano Enterprises*, 327 F. 2d 814, 816, n. 2 (C.A. 9).

In view of the testimony of employees Baltierra and Villasenor that Laguna had made similar antiunion statements to them, the Trial Examiner's decision to credit Martinez in this respect was well within the wide scope of his authority in this area.

[7] Before the Board, but apparently not here, petitioner erroneously relied on Section 10(b) of the Act and *Local Lodge No. 1424, IAM* v. *N.L.R.B. (Bryan Mfg. Co.)*, 362 U.S. 411, for the proposition that the Board may not establish the true motive for discharge through any antiunion statements or activities which occurred more than six months prior to the filing of the instant charge.

Section 10(b) provides, in relevant part: "[N]o complaint shall issue based upon any unfair labor practice occurring more than six months prior to the filing of the charge with the Board and service of a copy thereof upon the person against whom such charge is made . . ."

The Board did not here seek to establish any of those statements or activities as themselves unfair labor practices. Rather, the Board used them only to "shed light on the true character of [the] matters occurring within the limitation period . . ." *Bryan, supra*, 362 U.S. at 416. Indeed, the Court in *Bryan* expressly distinguished situations such as the one here presented from the type of situation then before it. *Id.*, at

Petitioner's asserted reasons for departing from seniority are so inconsistent with the facts of this case as to provide further support for the Board's finding that these reasons were mere pretexts seized upon by petitioner to mask its illegal motivation. *N.L.R.B.* v. *Dant*, 207 F. 2d 165, 167 (C.A. 9); see also, *N.L.R.B.* v. *Sebastopol Apple Growers Union*, 269 F. 2d 705, 710 (C.A. 9). It is undisputed that petitioner placed great weight on seniority. Thus, in determining whom to lay off in order to make room for Villasenor, petitioner admits to relying *exclusively* on seniority in narrowing the choice down to Martinez and Barunda (pet. br. p. 7). Thus, petitioner admittedly did not compare the past conduct of all its employees. Seniority was strictly applied until all but the two men junior in point of service were left for considera-

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416-417. In *Bryan*, the only activity within the 10(b) period was the enforcement of a union security agreement, valid on its face; this activity, by itself, was innocent and could be impeached only by resorting to an event outside the limitations period, *i.e.*, by showing that the union lacked majority status when it entered the agreement. Here, however, the illegality, *i.e.*, Martinez's discharge, occurred within the six months period and the only use of anterior evidence is in establishing the existence of the present, independent violation. It has been uniformly held, both prior to the *Bryan* opinion (*N.L.R.B.* v. *General Shoe*, 192 F. 2d 504, 507 (C.A. 6), cert. denied, 343 U.S. 904; *Superior Engraving Co.* v. *N.L.R.B.*, 183 F. 2d 783, 791 (C.A. 7), cert. denied, 340 U.S. 930; *Paramount Cap Mfg. Corp.* v. *N.L.R.B.*, 260 F 2d 109, 112-113 (C.A. 8)), and subsequent thereto (*Sheet Metal Workers* v. *N.L.R.B.*, 293 F. 2d 141, 146-147 (C.A. D.C.), cert. denied, 368 U.S. 896; *N.L.R.B.* v *Food Fair Stores*, 307 F. 2d 3, 7, n. 4 (C.A. 3); *N.L.R.B.* v. *Craig-Botetourt Electric Cooperative*, 337 F. 2d 374, 375 (C.A. 4)), that Section 10(b) does not bar the consideration of such relevant evidence in this manner.

tion, and only then did petitioner allegedly feel the need to consider past misconduct as well.

Petitioner contends that it departed from seniority considerations and kept Barunda, who was not a member of the Union, rather than Martinez, who was, because the latter had been involved in certain incidents of misconduct in the past. However, at no time was Martinez in any way disciplined for any of these incidents.[8] Quite to the contrary, almost immediately after one of these incidents, Martinez was transferred to the night shift from the substitute position. Although petitioner contended before the Board that this was in no sense a promotion for Martinez, it is undisputed that employment on the night shift carried with it a wage premium which the other employees, including Barunda who was in petitioner's employ at the time, did not receive.

In sum, this is a case where petitioner has demonstrated its antagonism to the Union from the inception of the organizing campaign to the start of the hearing in this matter, where seniority was considered

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[8] Petitioner erroneously asserts, at numerous places in its brief (pet. br. pp. 2-3, 4, 6, 7), that the Board *found* that Barunda was a better employee than Martinez. What the Board found was that Barunda had engaged in fewer instances of objectionable conduct than had Martinez (R. 61-62). But the Board further found that petitioner did not consider Martinez's misconduct to be of such magnitude as to prejudice his transfer in January 1963 from substitute status to the more desirable status of a full-time linotype operator (R. 63; Tr. 291, 329); nor did petitioner feel that Martinez's misconduct was of sufficient weight to prevent it from reemploying him in February 1964, shortly after the complaint in this case issued (R. 7, 61; Tr. 382-384).

by petitioner to be a decisive factor in determining which employees to retain except where departure from this criterion afforded an opportunity to retain a nonunion man and discharge an individual unshakably committed to the Union, and where the reasons offered for this departure were reasons upon which petitioner itself did not place any importance either before or after the discharge. In these circumstances, the Board's finding that Martinez was discriminatorily discharged is amply supported in the evidence.[9]

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[9] Petitioner has abandoned the contention that Laguna is not a supervisor. In any event, this contention is wholly inconsistent with the concession made by the Company in the earlier litigation that Laguna was a supervisor. See Brief for Respondent, *N.L.R.B.* v. *Lozano Enterprises*, 318 F. 2d 41, at p. 9. Indeed, it was on the basis of that concession that this Court applied the rule that an employer is responsible for the unfair labor practices of a supervising employee and thus held the Company responsible for Laguna's actions. 318 F. 2d at 42-43. There is no evidence, nor does petitioner contend, that Laguna's duties at the time here relevant are any different than his duties at the time when he was concededly a supervisor. Quite to the contrary, the evidence in this record conclusively establishes that Laguna was and is a supervisor within the meaning of the Act. Thus, 11 employees are under Laguna's supervision—the seven linotype operators and five employees in the press room. The immediate foreman of the press room employees is under the supervision of and takes orders from Laguna. Laguna directs the work of the linotype operators, assigns overtime work and assigns shifts to the employees in the linotype department. He hired Martinez for the Company. The existence of these factors conclusively establishes that Laguna is substantially responsible for non-routine matters and was therefore a supervisor. *N.L.R.B.* v. *Fullerton Publishing Co.*, 283 F. 2d 545, 548-550 (C.A. 9); *N.L.R.B.* v. *Greenfield Components Corp.*, 317 F. 2d 85, 88 (C.A. 1); *N.L.R.B.* v. *Inland Corp. of Virginia*, 322 F. 2d

CONCLUSION

For the reasons stated, it is respectfully submitted hat the petition to review should be denied, and that decree should issue enforcing the Board's order in ull.

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December 1965.

CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

Marcel Mallet-Prevost
Assistant General Counsel
National Labor Relations Board

157, 460 (C.A. 4); *Berhardt Bros. Tugboat Service* v. *N.L.R.B.*, 328 F. 2d 757, 758 (C.A. 7); *N.L.R.B.* v. *Hamilton Plastic Molding Co.*, 312 F. 2d 723, 726-727 (C.A. 6).

APPENDIX A

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, *et seq.*) are as follows:

Unfair Labor Practices

Sec. 8.(a) It shall be an unfair labor practice for an employer—

> (1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;
>
> * * * *
>
> (3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization;
>
> * * * *

Sec. 10 . . . (e) The Board shall have power to petition any court of appeals of the United States, . . . within any circuit . . . wherein the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall file in the court the record in the proceedings, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No

objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive.

* * * *

(f) Any person aggrieved by a final order of the Board granting or denying in whole or in part of relief sought may obtain a review of such order in any circuit court of appeals of the United States in the circuit wherein the unfair labor practice in question was alleged to have been engaged in or wherein such person resides or transacts business, or in the United States Court of Appeals for the District of Columbia, by filing in such court a written petition praying that the order of the Board be modified or set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Board, and thereupon the aggrieved party shall file in the court the record in the proceeding, certified by the Board, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall proceed in the same manner as in the case of an application by the Board under subsection (e) of this section, and shall have the same jurisdiction to grant to the Board such temporary relief or restraining order as it deems just and proper, and in like manner to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board; the findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall in like manner be conclusive.

* * * *

APPENDIX B

Pursuant to Rule 18(f) of the Rules of the Court

GENERAL COUNSEL'S EXHIBITS

No.	Identified	Offered	Rec'd in Evidence
1(a) thru 1(h)	4	4	4
2	29	30	31
4 thru 7	181	181	182

RESPONDENT'S EXHIBITS

3	41	195	195
4	60	79	79

☆ U. S. GOVERNMENT PRINTING OFFICE; 1965 794844 363

No. 20069

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LOZANO ENTERPRISES,

Petitioner,

v.

NATIONAL LABOR RELATIONS BOARD,

Respondent.

On Petition to Set Aside Decision and
Order of the National Labor Relations Board

PETITIONER'S OPENING BRIEF

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Los Angeles, California 90013
Attorneys for Petitioner

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---

PETITIONER'S OPENING BRIEF

I

JURISDICTION

The National Labor Relations Board issued its Decision and Order herein dated January 26, 1965, finding Petitioner guilty of a violation of Sections 8(a)(3) and (1) of the National Labor Relations Act. This Court has jurisdiction to review the Board's Decision and Order upon petition of Lozano Enterprises, a person aggrieved thereby, 29 U.S.C.A. § 160(f). Such petition was filed May 12, 1965.

II

CONCISE STATEMENT OF THE CASE AND QUESTIONS INVOLVED.

The facts of this case are simple:

Jose Nabor Villasenor was a night shift linotype operator for Lozano Enterprises when he was discharged. (TXD p. 2, lines 24-25.)[1] The Ninth Circuit thereafter decreed Villasenor's reinstatement. NLRB v. Lozano Enterprises, 318 F.2d 41 (9 Cir.1963).

Villasenor's reinstatement required his re-employment as a linotypist on the night shift, his position when terminated and for which a wage premium was paid. (TXD p. 4, lines 15-17.)

In order to make room for Villasenor, it was necessary to terminate another linotype operator. (TXD p. 3, lines 27-31.)

At the time of Villasenor's reinstatement, Javier Martinez was one of four night shift linotypists. (TXD p. 2, lines 43-51.)

Martinez was the most junior on the night shift and, in fact, was the most junior but one of all the linotypists in the entire plant. (TXD p. 3, lines 20-23).

Barunda, the only linotypist junior to Martinez,

---

[1] "TXD" refers to the Trial Examiner's Decision, adopted by the Board. The facts herein recited are those actually found by the Board.

was the better employee of the two. (TXD p. 5, lines 52-54; p. 8, line 55 - p. 9, line 1.)

Martinez was laid off due to the reinstatement of Villasenor. (TXD p. 2, lines 19-24.)

The question involved is:

1. Since Martinez was the most junior linotypist on the night shift, and since the only linotypist in the entire plant more junior to Martinez was a better employee (as found by the Board), was it discriminatory for Petitioner to lay off Martinez in order to reinstate Villasenor to the night shift?

The answer is that it was not discriminatory, and the conclusion of the Board that it was is directly contrary to and is unsupported by the facts found by the Board.

III

SPECIFICATION OF ERRORS

It was error for the Trial Examiner and the Board to conclude that Petitioner discriminated against Martinez and thus violated Sections 8(a)(3) and (1) of the Act.

IV

PETITIONER IN NO WAY DISCRIMINATED AGAINST MARTINEZ.

As shown above, the pertinent facts of this

case are simple. The Trial Examiner and the Board both found that Villasenor's reinstatement to the night shift required another linotypist to be laid off. Martinez, the one selected, was the most junior on the night shift and the next most junior in the entire plant. The only linotypist in the whole plant most junior to Martinez was a better employee, as found by the Board.

And yet, in the face of these facts as found, the Board concluded that Martinez was discriminated against and that, if there had been no discrimination, Petitioner would have selected the only employee junior to Martinez for the lay off. (TXD p. 10, lines 16-32.)

However, the one more junior employee that the Board says should have been selected for the layoff was, as found by the Board, a better employee than Martinez. Since he was a better employee, the Board's conclusion that he would have been the one laid off, absent discrimination against Martinez, is absolutely without support from the evidence. There simply is no reason at all to suppose that Petitioner would or should have laid off an employee who, as found by the Board, was better than Martinez.

The mere fact that Martinez was a member of the union does not in and of itself shield him from being laid off:

> "That [Martinez] was a union member and an active movant in the organizational drive

will not shield him from release for good cause. Martel Mills Corp., supra, at page 633. If discrimination may be inferred from mere participation in union organization and activity followed by a discharge, that inference disappears when a reasonable explanation is presented to show that it was not a discharge for union membership. N.L.R.B. v. Stafford, 8 Cir., 1953, 206 F.2d 19, 23."

NLRB v. United Brass Works, Inc.,
287 F.2d 689, 693 (4 Cir.1961).

See also:

NLRB v. Florida Steel Corp.,
308 F.2d 931, 935 (5 Cir.1962);

NLRB v. Threads, Incorporated,
308 F.2d 1, 13 (4 Cir.1962).

As said in Metal Processors' Union Local No. 16, AFL-CIO v. NLRB, 337 F.2d 114, 117 (D.C.Cir.1964), an inference that an employee was terminated on account of his union activities may not be drawn from the mere fact, as here, that the activities preceded the discharge. Likewise, the slight union animus found in this case by the Board (TXD p. 7, line 40 - p. 8, line 35) is insufficient in itself to ground an inference that Martinez' lay off was violative of the Act. Ibid.

The Second, Fourth, Fifth, Sixth, Seventh and Eighth Circuits all subscribe to the same proposition. Fort Smith Broadcasting Company v. NLRB, 341 F.2d 874, 878-79 (8 Cir.1965); NLRB v. Ace Comb Company, 342 F.2d 841, 847 (8 Cir.1965).

So does the Ninth Circuit, ever since 1943. As said in NLRB v. Citizens-News Co., 134 F.2d 970, 974 (9 Cir.1943):

> "The fact that a discharged employee may be engaged in labor union activities at the time of his discharge, taken alone, is no evidence at all of a discharge as the result of such activities. There must be more than this to constitute substantial evidence."

The present case is not a case where the Board found, contrary to Petitioner's testimony, that the most junior employee was not in fact the better employee; this is a case where the Board itself found that the most junior employee was better. In the face of this finding, the Board's decision that the better employee should have been laid off, rather than Martinez, is for the Board to intrude directly into the management of Petitioner's business. But this the Board cannot do; management is for management, and neither Board nor Court can second-guess it or give it guidance by over-the-shoulder supervision. NLRB v.

Sebastopol Apple Growers Union, 269 F.2d 705, 713 (9 Cir.1959

V

CONCLUSION

Petitioner deviated from a strict seniority lay-off by only one man. Except for that one man, Martinez was the most junior in the entire plant. With no exceptions, he was the most junior on the shift to which Villasenor had to be reinstated. The one man in the entire plant more junior than Martinez was, as found by the Board, a better employee.

Petitioner had to lay off someone to make room for Villasenor. The selection of Martinez was made on normal, logical and fair criteria. It was completely objective. It was not discriminatory.

And yet the Board now tells Petitioner that the one single more junior employee to Martinez should have been laid off instead. And the Board says this in the face of its own finding that this one employee was better. By its decision, the Board tells Petitioner to discriminate in favor of Martinez, because of his union activities, and against the better employee. The Act does not allow this. By its decision, the Board tells Petitioner that Martinez' union activities give him special protection against a necessary lay off. The Second, Fourth, Fifth, Sixth,

Seventh, Eighth, Ninth and District of Columbia Circuits do not allow this.

The Board should be reversed.

DATED: October 28, 1965.

Respectfully submitted,

SHEPPARD, MULLIN, RICHTER & HAMPTON

By _____
Frank Simpson
Attorneys for Petitioner,
Lozano Enterprises

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those Rules.

Frank Simpson

PROOF OF SERVICE

I, the undersigned, being first duly sworn, say that I am and was at all times herein mentioned a United States citizen and a Los Angeles, California, resident, over 18 years of age and not a party to the within action; that on 28 October 1965 I served the within Petitioner's Opening Brief on the below-named parties in said action, by depositing true copies thereof, enclosed in sealed envelopes with postage thereon fully prepaid, in a mail-box regularly maintained by the United States Government at Los Angeles, California, addressed as follows:

National Labor Relations Board (3 copies)
Washington 25, D.C.

General Counsel, National Labor Relations Board, 21st Region
849 South Broadway, Los Angeles, California 90014

James R. Webster, Esquire, Trial Examiner
National Labor Relations Board
Federal Building
450 Golden Gate Avenue
San Francisco, California

Shirley Schuster

Subscribed and sworn to before me 28 October 1965.

Notary Public, California
Principal office, Los Angeles County

E. M. DOIRON
My Commission Expires February 17, 1966

OFFICIAL SEAL
E. M. DOIRON
NOTARY PUBLIC - CALIFORNIA
PRINCIPAL OFFICE IN
LOS ANGELES COUNTY

No. 20068

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JIM GARVISON, ET AL., *Appellants*

v.

NORMAN A. JENSEN, *Appellee*

ON APPEAL FROM A JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON

BRIEF FOR AMALGAMATED MEAT CUTTERS AND BUTCHER WORKMEN OF NORTH AMERICA, AFL-CIO, AS AMICUS CURIAE

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BRIEF FOR AMALGAMATED MEAT CUTTERS AND BUTCHER WORKMEN OF NORTH AMERICA, AFL-CIO, AS AMICUS CURIAE

JURISDICTIONAL STATEMENT

This case is before the Court on appeal from a judgment of the District Court entered on February 2, 1965. In part the judgment invalidated the participation of retired employees and officers and employees of the contracting union as beneficiaries of jointly administered trust funds on the

ground that participation by these classes of employees was barred by section 302 of the Labor Management Relations Act, 1947.[1] The jurisdiction of the District Court was invoked under section 302(e) of that Act, empowering the "District Courts of the United States . . . to restrain violations of" section 302. The jurisdiction of this Court rests on 28 U.S.C. § 1291.

Leave to the Amalgamated Meat Cutters and Butcher Workmen of North America, AFL-CIO, to file a brief as *amicus curiae* was granted on May 24, 1965. The interest of *amicus curiae* is limited to the statutory eligibility of retired employees and officers and employees of the contracting union to participate as beneficiaries of a jointly administered trust fund. This amicus brief is confined to this question.

STATEMENT OF THE CASE

Pursuant to a collective bargaining agreement entered into on January 22, 1962, between Chapters of the Painting and Decorating Contractors of America and local unions of the Brotherhood of Painters, Decorators & Paperhangers of America, a medical-hospitalization trust fund which had been established in May 1953 was continued, and a pension fund was formed (58 LRRM at 2690; PTO, p. 3, ¶ 1[2]). Administration of each fund is reposed in eight trustees, four to be selected by the employers and four to be named by the union (58 LRRM at 2690). Employers contribute to both funds in amounts specified by two implementing Agreements and Declarations of Trust separately applicable to each fund (*ibid.;* PTO p. 2 ¶¶ 3, 5).

Each Declaration of Trust provides that the union could be treated as an employer with respect to certain of the

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1 29 U.S.C. § 186, 61 Stat. 157 (1947), as amended, 73 Stat. 538 (1959).

2 "LRRM" refers to the opinion of the District Court as reported at 58 LRRM 2689; "PTO" refers to the pretrial order; "pl. ex." refers to plaintiff's exhibits and "def. ex." to defendants' exhibits.

union's employees for the purpose of making contributions to the two funds for the benefit of these particular employees (58 LRRM at 2690). Coverage within the pension fund is prescribed by the following provision (pl. ex. 2, p. 2):

> It is understood that the Union party to this agreement may be considered an employer hereunder if permitted by law or governmental regulations to be so considered with respect to employees directly employed by such Union in its own affairs; provided, however, that the Union shall be considered as an employer hereunder in such event for the sole purpose of being able to include its employees as beneficiaries of this Pension Plan and shall not be considered as an employer for purposes of the obligations and rights reserved to employers otherwise defined herein and, provided, further, that only union employees who occupy positions in which they participate in the furtherance of the business of the Union may be so included as distinguished from clerical or stenographic employees.
>
> . . . The term "employee" as used herein . . . shall also include employees of the Union as hereinabove provided if the Union elects to include such employees as beneficiaries of the plan and so notifies the Trustees in writing of its election.

Coverage of union employees within the medical-hospitalization fund is prescribed under the term "associate employees" which includes *inter alia* "employees of the Union . . . whom the Union . . . elects to cover under this trust fund on a uniform nonselective basis, as determined by the Trustees" (pl. ex. 4, art. I, sec. 3, p. 2). Contributions on behalf of "associate employees" are fixed at "a monthly amount" which "shall be commensurate with the insurance premium charged to provide insurance coverage for employees within the bargaining unit. The Union, however, may elect to make payments on an hourly basis in the same amounts as provided by the collective bargaining agreement for those employees who occupy

positions in which they directly participate in the furtherance of the business of the Union, as distinguished from clerical or stenographic employees" (pl. ex. 4, art. III, sec. 1(j), pp. 6-7). Minor exceptions aside, it appears that coverage under the pension fund was extended to union business representatives and a financial secretary, and under the medical-hospitalization fund to the same individuals plus union stenographers.[3]

Since January 15, 1958, under the authority of a resolution adopted on that date, retired employees and their wives have been covered by the medical-hospitalization fund and medical benefit payments have been made to them (58 LRRM at 2690). To be eligible for participation the retired employee (1) must have been insured under the group policy between the carrier and the fund immediately preceding his date of retirement, and (2) on his retirement he must (a) have attained at least 65 years of age, (b) have completed at least 12 years of service in the industry after attaining the age of 45 years, (c) have had at least 12 months of coverage as an active employee since January 1, 1955, (d) be eligible for social security benefits, and (e) not be eligible for any benefits under the fund other than as a retired employee (def. exs. 1, 16 (p. 22), 24).

The pension and medical-hospitalization funds as jointly administered trusts created for the purpose of conferring benefits upon employees is regulated by section 302(c)(5) of the Labor Management Relations Act, 1947. Appellee contended, and the District Court agreed, that section 302(c)(5) bars retired employees and union officers and employees from eligibility to participate as beneficiaries of a jointly administered trust. Debarment of union officers and employees was predicated upon the view that employer status under the statute extends only to "an industrial employer . . . and not the union in its capacity as an

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[3] Plaintiff's brief in the District Court, pp. 6-7, 9-10.

employer of its own personnel" (58 LRRM at 2691). Debarment of retired employees was predicated upon the view that upon retirement "said persons are no longer employees" (*id.* at 2692).

THE INTEREST OF AMICUS CURIAE

Amalgamated Meat Cutters and Butcher Workmen of North America, AFL-CIO, is an international labor organization with about 335,000 members. Its 413 local unions represent employees throughout the United States, Canada and the Canal Zone. Its jurisdiction extends to meat packing houses, retail food stores, canneries, tanneries, poultry and fish companies, the fur trades, and related industries.

The District Court's interpretation of section 302(c)(5) vitally concerns the Meat Cutters. The interpretation bars retired employees from participating as beneficiaries of a jointly administered health and welfare fund. It bars union officers and employees from participating as beneficiaries of either a jointly administered health and welfare fund or a pension fund. As to them the bar is total.

The interpretation is in conflict with the premise upon which local unions of the Meat Cutters have negotiated jointly administered plans throughout the United States. In preparation for the appeal in *Blassie* v. *Kroger Co.*, 59 LRRM 2034 (C.A. 8, April 23, 1965), in which the Court of Appeals for the Eighth Circuit adopted an interpretation contrary to that of the District Court in this case, the Research Department of the Meat Cutters in May 1964 concluded a study to determine the incidence of coverage of retired employees and union officers and employees by jointly administered plans set up pursuant to collective bargaining agreements with Meat Cutters local unions. The study disclosed that, of 110 health and welfare plans, coverage of retired employees is provided in 53 (48 percent), and coverage of union officers and employees is provided in 99 (90 percent). Furthermore, of 69 pension

plans, coverage of union officers and employees is provided in 53 (77 percent).

The coverage of retired employees by jointly administered plans negotiated by Meat Cutters local unions epitomizes the general extension under collective bargaining of health and welfare benefits to retired employees (*infra*, pp. 13-18). The same is true of union officers and employees. While we have been unable to find any published statistics, the incidence of coverage disclosed by the Meat Cutters' study confirms the informed consensus that coverage under a jointly administered trust fund of the employees and officers of the contracting union is widespread. This extensive coverage of course reflects the general understanding that it is legal to include retired employees and union officers and employees as beneficiaries of a jointly administered trust fund. Indeed, until the decision of the District Court for the Eastern District of Missouri in January 1964 in *Kroger Co.* v. *Blassie*, 225 F. Supp. 300, since reversed by the Court of Appeals for the Eighth Circuit (*Blassie* v. *Kroger Co.*, 59 LRRM 2034, April 23, 1965), there had been no hint of illegality in such coverage during the sixteen and one-half years since the enactment of section 302 in 1947.[4] Based on the prevailing belief that it is lawful to extend pension, health, and welfare benefits to retired employees and union officers and employees via the medium of participation in jointly administered plans, compensation for work has been predicated in part upon the ultimate receipt of such benefits as a constituent of the consideration due, significant sums of money have been collected and invested to provide the

[4] For example, coverage of union officers and employees appears on the face of the opinion in *Sanders* v. *Birthright*, 172 F. Supp. 895, 899 (S.D. Ind.), with no intimation of illegality. Aside from the instant decision and the reversed decision in *Kroger Co.* v. *Blassie*, a third like decision was rendered in *United States Trucking Corp.* v. *Strong*, 239 F. Supp. 937 (S.D.N.Y.), presently on appeal to the Court of Appeals for the Second Circuit, No. 29,656. These decisions mushroomed since the January 1964 decision in *Kroger Co.* v. *Blassie*, after a preceding period of total quiescence.

promised protection, and important expectations of financial security during illness and old-age have been created in reliance on it. Safeguarding these interests from the latter-day notion that they have been built on an illegal base is the concern of amicus.

SUMMARY OF ARGUMENT

I

The extension of health and welfare benefits to retired employees is an important and growing part of the protection which the worker enjoys under collective bargaining. There is not the least doubt that no legal impediment exists to a negotiated plan extending health benefits to retired employees which is administered solely by the employer. The question reduces simply to whether it makes a difference that the plan is jointly administered. It would be wholly quixotic to say that the worker who during his active years received health benefits under a negotiated plan administered by the employer alone may continue to enjoy the benefits after his retirement but that the same employee receiving identical health benefits under a negotiated plan which happens to be jointly administered must be cut off at retirement. Whether Congress drew so bizarre a line is the question at issue.

Nothing in the words that Congress used supports such an incongruity. On the contrary, the text of section 302(c)(5) obviously contemplates that the benefits it allows may be extended to the worker after the termination of his status as an active employee. By the nature of the benefit this is necessarily true of "pensions on retirement," "unemployment benefits," and "severance or similar benefits," and there is not the least reason why it should not also be true of the coequal benefits of "medical or hospital care," "life insurance, disability and sickness insurance, or accident insurance."

Nor is there anything in the history or purpose of section 302(c)(5) which supports denial of health benefits to retired employees under a jointly administered plan. Three elements enter into the design of the section: (1) concern that a trust fund shall not be diverted from health and welfare purposes to unrelated ends, a mischief overcome by specifying that the trust shall be confined to specific health and welfare objects and shall be under joint employer-union administration; (2) within the health and welfare area the trust fund shall be allowed full range to serve health and welfare purposes; and (3) the limitation of the trust fund to the "sole and exclusive benefit of the employees" and the requirement of separate maintenance of a pension fund trace to the Internal Revenue Code and are designed simply to assure that the employer's contribution shall be a deductible business expense, the income of the trust fund shall be tax-exempt, and the employer's contribution shall not constitute income to the employee until he actually receives a benefit from the fund. Each of these three elements confirms the entire legality of giving health benefits to retired employees. Nothing in that benefit resembles or conduces to the mischief of the use of funds to perpetuate control of union officers, for political purposes, or for personal gain at which Congress aimed. It is, on the contrary, entirely within the area of health and welfare purposes which Congress did not trammel. And the payment of health benefits to retired employees is wholly within the tax consequences which Congress wished to assure. Indeed, the federal tax regulations, in effect at the enactment of section 302 as now, confer tax-exempt status on plans which cover "former employees" (*infra*, pp. 31-35).

The history of congressional action since the enactment of section 302 further confirms the permissibility of extending health benefits to retired employees. In 1959, Congress amended the section to add that a jointly administered trust fund could be established "for the purpose of pooled

vacation, holiday, severance or similar benefits, or defraying costs of apprenticeship or other training programs." It is to the last degree unimaginable that, in the face of this explicit expansion to remove doubt as to the legality of these purposes, Congress thought that it had in 1947 enacted, or in 1959 would have continued, a prohibition against health benefits for retired employees. And other federal enactments adopted in 1959, 1960, and 1962 dealing with health benefits for the retired employee show the solicitude of Congress for him and the untenability of imputing to Congress any intention that section 302 shall preclude the grant of health benefits to him.

II

Section 302(c)(5) does not bar participation by employees and officers of the contracting union as beneficiaries of a jointly administered trust fund. The union is of course a distinct entity with the status of an employer vis-a-vis its own employees. This conclusion is indeed compelled by satutory definition. And section 302(c)(5) explicitly states that different employers may contribute to a single trust fund. As a separate and distinct employer, the union is part of the class of "employers" who, in the words of section 302(c)(5), may make "similar payments" for their employees who participate "jointly" as beneficiaries.

The participation of union employees and officers in the fund as beneficiaries conduces to no evil at which section 302(c)(5) is aimed. There is no risk in their coverage which does not inhere in the coverage of any group of employees. "We see no particularized danger of abuse. Payments are made to a jointly administered fund. There is present only the same possibility of abuse which is at hand when any trustee or group of trustees chooses to be dishonest." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2043-44 (C.A. 8, April 23, 1965). It would be a wholly unnatural state of affairs, and therefore is a wholly

artificial reading of the statute, to exclude from the benefits of the fund the employees and officers of the contracting union who serve the interests of all the employees and should therefore be expected to share the same employment benefits with them. Indeed, under the terms of the Internal Revenue Code, to which the words of section 302(c)(5) directly trace, officers are explicitly enumerated as eligible to participate as beneficiaries of a trust fund.

Of course the union may have no voice in choosing the employer representatives on the fund. For while the union is an employer vis-a-vis its own employees, it is also an employee representative, and in view of its dominating characteristic as an employee representative it would do violence to the principal of equal representation were it to share in the selection of the employer representatives. The union's dual role requires its nonparticipation in choosing the employer representatives but does not require debarment of its employees from coverage as fund beneficiaries.

No other precluding considerations exist. It is wholly irrelevant that particular union officers, by virtue of their high rank and consequent managerial status, may not combine to bargain collectively with the union through a bargaining representative of their own choice. "The right collectively to bargain is an entirely different question." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2045 (C.A. 8, April 23, 1965). Nor is there the slightest basis for supposing that the union, in participating in the jointly administered fund in its capacity as an employer of its own employees, would have a conflict of interest in discharging its function as an employee representative. That "remote possibility" is too minimal and tangential to be persuasive; it "does not fall into that category of mischiefs which the legislative history reveals to be the target of the statute." *Id.* at 2044-45.

ARGUMENT

Section 302 of the Labor Management Relations Act, 1947, Does Not Bar Retired Employees From Participating As Beneficiaries of the Medical-Hospitalization Trust Fund and Union Officers and Employees From Participating As Beneficiaries of the Medical-Hospitalization Trust Fund and the Pension Fund

Section 302 of the Labor Management Relations Act, 1947, governs the question whether retired employees are statutorily barred from receiving health and welfare benefits from a jointly administered health and welfare fund, and whether union officers and employees are statutorily barred from receiving pension, health, or welfare benefits from a jointly administered but separately established health and welfare fund and pension fund. Section 302(a) is a general prohibition against an employer giving any money or other thing of value to a union or its representatives and section 302 (b) prohibits any person from receiving a payment prohibited by (a).[5] Section 302 (c) contains six

[5] Sec. 302. (a) It shall be unlawful for any employer or association of employers or any person who acts as a labor relations expert, adviser, or consultant to an employer or who acts in the interest of an employer to pay, lend, or deliver, or agree to pay, lend, or deliver, any money or other thing of value—

(1) to any representative of any of his employees who are employed in an industry affecting commerce; or

(2) to any labor organization, or any officer or employee thereof which represents, seeks to represent, or would admit to membership, any of the employees of such employer who are employed in an industry affecting commerce; or

(3) to any employee or group or committee of employees of such employer employed in an industry affecting commerce in excess of their normal compensation for the purpose of causing such employee or group or committee directly or indirectly to influence any other employees in the exercise of the right to organize and bargain collectively through representatives of their own choosing; or

(4) to any officer or employee of a labor organization engaged in an industry affecting commerce with intent to influence him in respect to any of his actions, decisions, or duties as a representative of employees or as such officer or employee of such labor organization.

(b)(1) It shall be unlawful for any person to request, demand, receive, or accept, or agree to receive or accept, any payment, loan, or delivery of any money or other thing of value prohibited by subsection (a).

exceptions to the ban, of which exceptions (5) and (6) are presently relevant. Exception (5) provides that the prohibition "shall not be applicable":

> (5) with respect to money or other things of value paid to a trust fund established by such representative, for the sole and exclusive benefit of the employees of such employer, and their families and dependents (or of such employees, families, and dependents jointly with the employees of other employers making similar payments and their families and dependents):

Three qualifications, (A), (B), and (C), are placed upon this exception. Qualification (A) states that:

> (A) such payments are held in trust for the purpose of paying, either from principal or income or both, for the benefit of employees, their families and dependents, for medical or hospital care, pensions on retirement or death of employees, compensation for injuries or illness resulting from occupational activity or insurance to provide any of the foregoing, or unemployment benefits or life insurance, disability and sickness insurance, or accident insurance:

Qualification (B) states that:

> (B) the detailed basis on which such payments are to be made is specified in a written agreement with the employer, and employees and employers are equally represented in the administration of such fund, together with such neutral persons as the representatives of the employers and the representatives of employees may agree upon and in the event the employer and employee groups deadlock on the administration of such fund and there are no neutral persons empowered to break such deadlock, such agreement provides that the two groups shall agree on an impartial umpire to decide such dispute, or in event of their failure to agree within a reasonable length of time, an impartial umpire to decide such dispute shall, on petition of either group, be appointed by the district court of the United States for the district where the trust fund has its principal office, and shall also contain provisions for an annual audit of the trust fund, a statement of the results of which shall be available for

> inspection by interested persons at the principal office of the trust fund and at such other places as may be designated in such written agreement;

Qualification (C) states that:

> (C) such payments as are intended to be used for the purpose of providing pensions or annuities for employees are made to a separate trust which provides that the funds held therein cannot be used for any purpose other than paying such pensions or annuities;

Finally, subject to the applicability of qualification (B), exception (6) authorizes an employer to contribute to a trust fund "for the purpose of pooled vacation, holiday, severance or similar benefits, or defraying costs of apprenticeship or other training programs."

I. SECTION 302(c)(5) OF THE LABOR MANAGEMENT RELATIONS ACT, 1947, DOES NOT BAR AN ACTIVE EMPLOYEE UPON HIS RETIREMENT FROM CONTINUING AS THE BENEFICIARY OF A JOINTLY ADMINISTERED HEALTH AND WELFARE PLAN.

We shall show, as the Court of Appeals for the Eighth Circuit held, that "a person for whom employer contributions are made prior to retirement is not barred from receiving benefits of the Trust after retirement, and that this qualification is not nullified by additional contributions made by him or by others in his behalf." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2040, decided April 23, 1965.

A. The Extension of Health and Welfare Benefits to Retired Employees is an Important and Growing Part of the Protection Which the Workers Enjoy Under Collective Bargaining.

"A statute, like other living organisms, derives significance and sustenance from its environment, from which it cannot be severed without being mutilated."[6] Hence, in-

[6] Mr. Justice Frankfurter dissenting in *United States* v. *Monia*, 317 U.S. 424, 432.

dispensable to consideration of the legal question whether under section 302 (c)(5) of the Labor Management Relations Act, 1947, an active employee upon his retirement may continue as the beneficiary of a jointly administered health and welfare plan is knowledge of the environment in which the question exists and therefore the probable attitude of Congress to it. In a nutshell the extension of health and welfare benefits to retired employees is an important and growing part of the protection which the worker enjoys under collective bargaining. It gives to him in his twilight years when the need is greatest the means of meeting the expenses of illness.

"The trend of welfare plans toward the inclusion of retired persons is a fact of today's industrial life. . . ." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (C.A. 8, April 23, 1965). The statistics tell the story. In 1960-1961 the Bureau of Labor Statistics published a four-part study entitled Health and Insurance Plans Under Collective Bargaining.[7] The representative character of the study was explained as follows:[8]

> The 300 health and insurance plans studied were selected to provide a broadly representative view of the type of protection provided by major plans under collective bargaining, i.e., those covering 1,000 or more workers. Factors given primary consideration in the selection of the sample were industry, geographic location, type of bargaining unit, and size of plan as measured by active worker coverage. The 300 selected plans, which ranged in coverage from 1,000 to a half million workers, provided health and insurance benefits to a

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[7] Generally entitled Health and Insurance Plans Under Collective Bargaining, the study is divided into Hospital Benefits, Early 1959, B.L.S. Bull. No. 1274, U.S. Dep't. Lab. (March 1960); Surgical and Medical Benefits, Late Summer 1959, B.L.S. Bull. No. 1280, U.S. Dep't. Lab. (November 1960); Major Medical Expense Benefits, Fall 1960, B.L.S. Bull. No. 1293, U.S. Dep't. Lab. (May 1961); Life Insurance and Accidental Death and Dismemberment Benefits, Early Summer 1960, B.L.S. Bull. No. 1296, U.S. Dep't. Lab. (June 1961).

[8] Bull. No. 1274, *op. cit. supra*, n. 7, at 2-3.

> total of 4.9 million workers . . ., or about 40 percent of the estimated number of workers under all health and insurance plans under collective bargaining agreements. . . .
>
> Virtually every major manufacturing and non-manufacturing industry was represented in the sample studied. . . . Almost 3 out of 4 plans (219), covering two-thirds of the workers, were in manufacturing industries. Nearly a third of the plans (95), covering more than 40 percent of the workers, were negotiated by multiemployer groups.

The study divided the available health and welfare benefits into four classes: hospital benefits, surgical and medical benefits, life insurance and accidental death and dismemberment benefits, and major medical expense benefits. "All but two plans provided hospital benefits."[9] The extension of hospital benefits to retired employees has rapidly expanded. Thus, "coverage of retired workers and their dependents rose from about 20 percent of the plans in 1955 to almost 40 percent in 1959. . . ."[10] "Retired workers and their dependents were provided benefits under almost two out of five of the plans with benefits for the active workers and their dependents, respectively . . .—a sharp increase over 1955 when only one out of four plans extended benefits to retired workers and one out of five extended them to retired workers' dependents."[11]

The story as to surgical and medical benefits is much the same. "Of the 300 plans studied, surgical benefits were provided active workers and their dependents by 293 and 282 plans, respectively. . . . Retired workers and their dependents received surgical benefits under 103 and 100 plans, respectively, covering about 40 percent of all workers in the 300 plans studied. . . . Medical benefits were provided by 7

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[9] Bull. No. 1274, *op. cit. supra*, n. 7, at 4.

[10] *Ibid.*

[11] *Id.* at 25.

out of 10 of the plans studied (213). . . . Retired workers and their dependents received medical benefits under 74 and 71 plans, respectively, covering over 30 percent of the workers in the sample." [12] Here too the keynote is expanding coverage. "Since 1955, the number of plans providing surgical coverage for retired workers increased from 19 percent of all plans studied to 34 percent, and coverage for their dependents rose from 16 percent to 33 percent of the plans. . . . Coverage of retired workers by medical benefits increased from 12 percent to 25 percent of the plans studied and for their dependents, from 10 percent to 24 percent." [13]

Although the pattern is more checkered, the story of significant and expanding coverage prevails as well with respect to life insurance and accidental death and dismemberment benefits. "Life insurance was provided active workers by 295 of the 300 plans studied. . . . This benefit was extended to retired workers by almost 2 out of 3 of these plans (189) representing the same proportion of the workers in the sample. . . . Accidental death and dismemberment benefits were included in somewhat more than half of the 300 plans studied (162), covering less than half of the workers (47 percent). . . . In contrast with the extension of life insurance, less than 5 percent of these plans provided benefits for retired workers, and no plan had such coverage for dependents." [14] While life insurance benefits for active workers and their dependents has remained about the same, "coverage of retired workers increased from 49 percent of the plans in 1955 to 63 percent in 1960. During the same period, there was little change in accidental death and dismemberment benefit coverage of both active and retired workers." [15]

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12 Bull. No. 1280, *op. cit. supra*, n. 7, at 2-3.

13 *Id.* at 6.

14 Bull. No. 1296, *op. cit. supra*, n. 7, at 2-3.

15 *Id.* at 3.

Major medical expense benefits—otherwise known as catastrophic illness insurance—is the final class. "Of the 300 health and insurance plans under collective bargaining studied, 43, covering about 1,200,000 workers, provided major medical benefits for active workers. . . . Dependents of active workers were covered by 39 plans. Nine plans continued coverage for retired workers and eight for their dependents." [16]

In negotiating health and welfare benefits for retired employees, coverage is very often extended to the worker who has already retired as well as to the worker to be retired. "When 112 major collectively bargained health and insurance plans made provision for the extension of health benefits to workers upon retirement, two-thirds (76) also extended coverage to employees who had already retired. In virtually every such instance, prior pensioners were to receive the same benefits and make the same contributions, if any, as future pensioners. The cost of the pensioners' benefits was to be paid by the employers in nearly half the plans, and by both groups in all but one of the remaining plans. All but 2 of the 76 plans providing for the coverage of prior pensioners extended health benefits to them at the same time as to future pensioners." [17]

This important and expanding extension of health and welfare benefits to the retired employee is the consequence of "the growing recognition of the health needs of retired workers on the part of employers and unions." [18] It is "a

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[16] Bull. No. 1293, *op. cit. supra.* n. 7, at 5.

[17] Landay, *Extension of Health Benefits to Prior Pensioners,* 83 Monthly Lab. Rev. 841 (August 1960).

[18] Spiegelman, Ensuring Medical Care for the Aged, 213 (1960). See also, Health Benefit Plans Under Collective Bargaining, U.S. Dept. Health, Ed. and Lab., Soc. Sec. Admin., Div. Research and Statistics, Research and Statistics Note No. 1, February 13, 1964; Kittner, *Recent Changes in Negotiated Health and Insurance Plans,* 85 Monthly Lab. Rev. 1015 (Sept. 1962). And see, Shaffer, Health Care Plans and Medical Practice, Editorial Research Reports, June 20, 1962; Medical Care for the Aged, Congressional Quarterly Service, Special Report, August, 1963.

significant indication of the real drive that industry, labor, and many carriers are making to meet the problem."[19] There is not the least doubt that the social good is entirely served by provision for health benefits for the senior citizen through the private effort of management and labor. There is similarly not the least doubt that no legal impediment exists to a negotiated plan extending health benefits to retired employees which is administered solely by the employer. The question reduces therefore to whether it makes a difference that the plan is jointly administered. Manifestly the social good is identical and the need of the retired employee the same whether the administration of the plan is single or joint. Nor is there anything in the difference between single and joint administration which is germane to the extension of health benefits to the retired employee. It would be wholly quixotic to say that the worker who during his active years received health benefits under a negotiated plan administered by the employer alone may continue to enjoy the benefits after his retirement but that the same employee receiving identical health benefits under a negotiated plan which happens to be jointly administered must be cut off at retirement. Whether Congress drew so bizarre a line is the question at issue.

B. The Text of Section 302(c)(5) Validates the Extension of Health Benefits to Retired Employees.

Section 302(c)(5) permits the establishment of a trust fund "for the sole and exclusive benefit of *employees* of such employer . . ." (emphasis supplied). The Court of Appeals for the Eighth Circuit construed the term "employees" "to mean covered current employees and persons who were covered current employees but are now retired. This is not non-literal construction but one which, we think, comports with the ordinary and literal meaning of the term." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2042 (C.A. 8, April 23, 1965). The Eighth Circuit thus rejected the

[19] Somers and Somers, Doctors, Patients, Health Insurance, 434 (1961).

view of the District Court in that case that "Retired personnel are not *employees* of the contributing employers and cannot legally be included as beneficiaries under" the trust. *Kroger Co.* v. *Blassie,* 225 F. Supp. 300, 307-308 (E.D. Mo.) (emphasis in original). This Court should similarly reject the identical view of the District Court in this case that retired "persons are no longer employees" (58 LRRM at 2692).

The restricted reading of the term "employees" does not survive an examination of the text of the section as a whole. The premise of the reading is that the word "employee" must mean a worker who occupies active status. This premise is irreconcilable with the permitted benefits explicitly enumerated by the section for which the "employees" are eligible. These include "pensions on retirement," "unemployment benefits," and "severance or similar benefits." Each benefit contemplates cessation of active status by the employee. A pension is payable precisely because the employee has retired; an unemployment benefit is payable precisely because the employee is no longer working; a severance benefit is payable precisely because the employee's status with his employer has terminated. Thus the "statute by its very language obviously contemplates the enjoyment of certain benefits after an employee's retirement or while he is inactive." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (C.A. 8, April 23, 1965). It is evident, therefore, that a contribution to a trust fund does not cease to be "for the sole and exclusive benefit of the employees" simply because the benefit inures to the employee after termination of his active status. And since that is true of "pensions on retirement," "unemployment benefits," and "severance or similar benefits," there is not the least reason why it should not also be true of "medical or hospital care," "life insurance, disability and sickness insurance, or accident insurance." The retired employee who needs a pension to provide food, clothing and shelter also needs the wherewithal to prevent and cure

illness. Nothing in the words Congress used supports an invidious choice by it between the two needs.

Nor can textual support for the restricted reading of the term "employees" be drawn from subpart (C) of section 302(c)(5). That subpart states, as a requirement pertinent to pensions, that "such payments as are intended to be used for the purpose of providing pensions or annuities for employees are made to a separate trust which provides that the funds held therein cannot be used for any purpose other than paying such pensions or annuities." Based on the requirement of the separateness of a pension fund the inference is drawn that a welfare fund is prohibited from conferring health benefits on retired employees. *Kroger Co.* v. *Blassie*, 225 F. Supp. 300, 307 (E.D. Mo.). That inference, observed the Court of Appeals for the Eighth Circuit in reversing, is not "apparent to us." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (C.A. 8, April 23, 1965). All that the prohibition against commingling can mean is that a pension trust and a welfare trust shall be set up separately. It does not mean that, given a welfare fund separately established from a pension fund, the welfare fund is forbidden to grant health benefits to retired employees. On the contrary, the requirement of separateness has no relevance at all to support disentitlement of a retired employee from receiving health benefits from a distinct and segregated welfare trust.

Thus, the text does not support, and the legislative history, to which we now turn, refutes the notion that a retired employee is ineligible to receive health benefits from a jointly administered welfare trust. And salutary in resolving any doubt is the preference expressed by the Eighth Circuit for "a construction policy favoring inclusion and benefits where there is no statutory language or inference of exclusion, rather than one favoring exclusion and a denial of benefits where there is no positive language of inclusion." *Blassie* v. *Kroger Co., supra*, 59 LRRM at

2040. The District Court's observation in this case that an exception to a general prohibition should be narrowly construed (58 LRRM at 2692) "need not detain us; insights derived from syntactical analysis form a hazardous basis for the explication of major legislative enactments." *Local Lodge No. 1424, Machinists* v. *N.L.R.B.*, 362 U.S. 411, 417, n. 7.

C. The Legislative History of Section 302(c)(5) Supports the Extension of Health Benefits to Retired Employees.

Three elements emerge from the legislative history: (1) concern that a trust fund shall not be diverted from health and welfare purposes to unrelated ends, a mischief overcome by specifying that the trust shall be confined to specific health and welfare objects and shall be under joint employer-union administration; (2) within the health and welfare area the trust fund shall be allowed full range to serve health and welfare purposes; and (3) the limitation of the trust fund to the "sole and exclusive benefit of the employees" and the requirement of separate maintenance of a pension fund trace to the Internal Revenue Code and are designed simply to assure that the employer's contribution shall be a deductible business expense, the income of the trust fund shall be tax-exempt, and the employer's contribution shall not constitute income to the employee until he actually receives a benefit from the fund. Each of these three elements confirms the entire legality of giving health benefits to retired employees. Nothing in that benefit resembles or conduces to the mischief at which Congress aimed. It is, on the contrary, entirely within the area of health and welfare purposes which Congress did not trammel. And the payment of health benefits to retired employees is wholly within the tax consequences which Congress wished to assure.

1. *The general background:* The regulation of trust funds via section 302(c)(5) of the Labor Management Relations Act, 1947, was enacted in 1947 "as part of a compre-

hensive revision of federal labor policy in the light of experience acquired during the years following passage of the Wagner Act, and was aimed at practices which Congress considered inimical to the integrity of the collective bargaining process.''[20] The trust fund subject had first been importantly explored in 1946 when, during deliberation on the Senate floor of the Case bill[21] which was the precursor to the Taft-Hartley Act passed in 1947, Senator Byrd proposed an amendment which would prohibit payment by an employer and conversely receipt by a representative of employees of money or other thing of value.[22] During congressional consideration of trust fund regulation prominent reference was made to two papers published in the Monthly Labor Review, one in 1945[23] and one in 1947,[24] which provided the legislators with their factual frame of reference.[25] These showed that negotiated plans were rare until the advent of the national wage stabilization policy during World War II encouraged improvements in employment conditions through health and welfare benefits in lieu of wage increases during this period. In 1945, some 600,000 workers were included under such plans; by early 1947 about 1,250,000 were covered. The plans ranged widely. Cash benefits were provided to help defray the cost of sickness and accidents, including maternity incapacity, hospital expenditures, surgical costs, death, and dismemberment. Life insurance and pensions were

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20 *Arroyo* v. *United States*, 359 U.S. 419, 425.

21 H.R. 4908, 79th Cong., 2d Sess.

22 92 Cong. Rec. 4809.

23 Health-Benefit Programs Established Through Collective Bargaining, B.L.S. Bull. No. 841, 61 Monthly Lab. Rev. 191 (August 1945). See also, Baker and Dahl, Group Health Insurance and Sickness Benefit Plans in Collective Bargaining (1945), summarized in 17 LRRM 2521.

24 Union Health and Welfare Plans, 64 Monthly Lab. Rev. 191 (February 1947).

25 92 Cong. Rec. 4892, 5264, 5333, 5338; 93 Cong. Rec. 4037, 4747, 4748, 4752; S. Min. Rep. No. 105, 80th Cong., 1st Sess., 24.

afforded. Benefits were extended to laid-off employees. Health centers were established to provide medical care. And while the fact is not mentioned in the papers, plans negotiated with affiliates of the International Ladies Garment Workers Union granted benefits to retired employees.[26]

[26] This statement is based on a memorandum received from the ILGWU dated March 31, 1964, which reads as follows:

> We are advised that a recent court decision holds that a Health and Welfare Fund may only make payments to, or on behalf of employees—not retirees or former employees.
>
> From the inception of the ILGWU Death Benefit Fund in 1937 to 1947 the death benefit was $150. Regular workers paid $1 a year for such coverage. Those who retired from the trade and continued to receive death benefit coverage paid $2 a year for the same coverage. (Those not working in the trade are deemed, as a group, a higher risk).
>
> As of July 1, 1947 the death benefit coverage was increased to $500 with those working in the trade still paying $1 a year with a Health and Welfare Fund paying an additional $3 a year for the extra coverage. Such payments were made for death benefit coverage retroactive to Jan. 1, 1947. Those retired from the trade were required to pay $4 a year for $500 coverage.
>
> In 1950 the maximum death benefit coverage was raised to $1000. Those working in the trade still paid $1 a year supplemented by a $7 annual payment by a Health and Welfare Fund. Members retired from the trade were required to pay $8 a year for the same $500 coverage.
>
> The right of members not working in the trade, more particularly retirees of industry retirement funds, to death benefit coverage developed out of, and was a continuation of, their previous coverage as workers in the trade whose death benefit payment was supplemented by payments from the Health and Welfare Fund.
>
> The ILGWU Death Benefit Fund has paid death benefits of $150 and of $500 to members retired from the trade prior to as well as after Jan. 1, 1947.
>
> One who retires from the trade and is eligible to continue death benefit coverage is known as a "continuing member" after withdrawal. (Art. 13, Sec. 13a of ILWGU Constitution). This emphasizes the continuity of death benefit coverage first, as a worker in the trade and, later, as one who has retired from the trade.
>
> In addition to continued death benefit coverage retired members also receive the privilege of continued treatment, as required, at the Union Health Center. Payments for such medical services were made by the Health and Welfare Fund before as well as after Jan. 1, 1947.
>
> It is presumed that legislation that became effective in Sept. 1947 was drafted with knowledge of the existence of the practice of providing retired workers with continued medical as well as death benefit protection.

2. *Health benefits on retirement not within the evil at which Congress aimed:* It was not the establishment of trust funds to confer health and welfare benefits, but rather concern that the funds might be diverted to unrelated purposes, which was the reason that Congress undertook to regulate them. The immediate impetus to legislative action was the demand by the United Mine Workers in 1946 for the creation of a welfare fund under the exclusive control of the union.[27] Congress feared "the possible abuse by union officers of the power which they might achieve if welfare funds were left to their sole control"; it was apprehensive that "such funds might be employed to perpetuate control of union officers, for political purposes, or even for personal gain."[28] To overcome this evil Congress defined the purposes for which the fund could be established, required that the benefits payable be specified in detail in the trust agreement, and prescribed joint union-employer administration of the fund.[29]

It is manifest that conferment of health benefits upon retired employees is "not an evil at which the statute is directed." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (C.A. 8, April 23, 1965). It is surely not the employment of trust funds "to perpetuate control of union officers, for political purposes, or . . . for personal gain." It does not make labor unions "so powerful that no organized government would be able to deal with them";[30] it is no grant of "tribute" to the union;[31] it is not "used for political or other purposes,"[32] or for "aggrandizement";[33]

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27 *United States* v. *Ryan*, 350 U.S. 299, 304-305; *Arroyo* v. *United States*, 359 U.S. 419, 426.

28 *Arroyo* v. *United States*, 359 U.S. 419, 426.

29 92 Cong. Rec. 4892-4894, 4899, 4900, 5064, 5180, 5338, 5339, 5346, 5494, 5930; S. Rep. No. 105, 80th Cong., 1st Sess., 52 (Supplemental Views); 93 Cong. Rec. 4678, 4746-48, 4752-4753.

30 92 Cong. Rec. 4892, 4893.

31 92 Cong. Rec. 4893, 4894.

32 92 Cong. Rec. 4899.

33 92 Cong. Rec. 5180, 5181.

it is not a benefit classifiable as "covering every field . . .—housing, welfare, education, anything the union may decide it wants to spend the money for";[34] it is not within the area of "housing, or education, or government";[35] it does not "divert funds . . . to the union treasury or the union officers";[36] it is not "subject to racketeering or arbitrary dispensation by union officers";[37] it does not "become a mere tool to increase the power of the union leaders over their men,"[38] or a "war chest for the particular union."[39] In short, health benefits for retired employees present no danger that they "will be used for the personal gain of union leaders, or for political purposes, or other purposes not contemplated when they were established, and that they will in fact become rackets."[40] The intrinsic character of health benefits is identical whether the recipient is an active or a retired employee. Like other benefits which are concededly permissible, so with health benefits for retired employees, joint administration exists as the safeguard erected to protect against diversion from authorzied purposes. And so, as legislation " 'must be read in the light of the mischief to be corrected and the end to be attained' " (*N.L.R.B.* v. *Hearst Publications*, 322 U.S. 111, 124), the statute cannot be construed to condemn health benefits for retired employees, a beneficence altogether outside the evil at which Congress aimed.

3. *Health benefits on retirement part of the positive good that Congress served:* It is not simply that health benefits

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[34] 92 Cong. Rec. 5338.

[35] 92 Cong. Rec. 5494.

[36] S. Rep. No. 105, 80th Cong., 1st Sess., 52 (Supplemental Views).

[37] *Ibid.*

[38] *Ibid.*

[39] 93 Cong. Rec. 4747.

[40] 93 Cong. Rec. 4678.

for retired employees are not within the mischief that Congress sought to control. They are, more than that, part of the positive good which Congress sought affirmatively to serve. "The statute . . . speaks broadly of benefits. It specifies benefits for medical or hospital care, and for injuries or illness, and for disability and sickness, and for accident. Misfortune of this kind is not confined to the active employee. It strikes the retired one as well and, because of his age, with greater frequency." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (C.A. 8, April 23, 1965). "It is a commonplace of modern industrial relations for employers to provide security for employees and their families to meet problems arising from unemployment, illness, old age or death." [41] Congress favored the well-rounded realization of this commonplace and was careful to explain that it placed no unjust impediments in the way of creation of trust funds to further the development of health and welfare objectives.

Trust fund regulation was initiated by an amendment proposed by Senator Byrd, and he repeatedly emphasized that "I am not objecting to the establishment of health and welfare funds for workers; I am in favor of it";[42] "It would still be possible to establish a health program and place the money under joint control";[43] "it does not in any way prohibit the establishment of a health fund, if it should be controlled by mutual agreement, and not go directly to the union." [44] Senator Byrd reiterated that:[45]

> The purpose is to make sure that the prohibitions contained in my amendment do *not* apply to the payment of any money or other thing of value to an organ-

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41 *Lewis* v. *Benedict Coal Corp.*, 361 U.S. 459, 468.

42 92 Cong Rec. 4892.

43 92 Cong. Rec. 4893.

44 92 Cong. Rec. 4894.

45 92 Cong. Rec. 5040.

> ization or fund *for furnishing health, welfare or other benefits* if employers and employees are both represented in the administration of such organization or fund. . . .[Emphasis supplied.]

As expressed by Senators Morse and Stanfill, any objection to "a health and welfare fund" would be removed by joint administration.[46] Granted joint administration, Senator Overton explained, "There is nothing . . . in the amendment that inhibits the establishment of health and hygienic programs, welfare programs, recreational programs or other programs beneficial to labor."[47]

Senator Taft was the principal architect of the Labor Management Relations Act, 1947. He stated that "the Byrd amendment is a very reasonable one. I do not see any objection to it. I do not consider that it will stand in the way of the establishment of *any reasonable* health fund which the union may wish to establish."[48] Referring to existing funds, he observed that "every fund that is mentioned in the particular pamphlet . . . is authorized by the amendment, as changed, with the exception of the single question of the administration of the fund."[49] "We have a very detailed knowledge of these different funds, and I feel quite confident that the language of the amendment is broad enough to cover every fund in existence."[50] The gamut of existing funds, Senator Taft explained, did not exhaust but simply illustrated the range of permitted benefits:[51]

> It seems to me the main point is that there should be a definition, and the definition contained in section 3(a) is *broad enough to cover every existing fund and*

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[46] 92 Cong. Rec. 5064.

[47] 92 Cong. Rec. 5180.

[48] 92 Cong. Rec. 5338 (emphasis supplied).

[49] *Ibid.*

[50] 92 Cong. Rec. 5339.

[51] 92 Cong. Rec. 5338.

> *would justify the setting up by the coal miners of a more extensive fund,* if they wished, than that set up under the existing plan described in the amendment. [Emphasis supplied.]

There is no objection to "a fund for health purposes clearly outlined in a collective-bargaining agreement. . . . The Byrd amendment carefully defines the recognized forms of health and welfare benefits which such funds have been used for, and which have been legislated about in the Internal Revenue Code, which are found to be funds for beneficial purposes, which should receive special tax exemption, and should have special consideration from the Government." [52]

Congressman Case observed that "the purposes of the fund are quite broad and the fund may be used for accident insurance, compensation for death or disability, *or anything of that sort.* Therefore, the Byrd amendment does not prevent a welfare fund but legalizes it and provides for joint management on the part of those who contribute to it." [53]

The theme thus sounded in 1946 was the unchanged motif which prevailed in 1947. Senators Taft, Ball, Donnell, Jenner, and Smith stated that:[54]

> It does not prohibit welfare funds but merely requires that, if agreed upon, such funds be jointly administered —be, in fact, trust funds for the employees, with definite benefits specified, to which employees are clearly entitled, and to obtain which they have a clear legal remedy.

The permitted purposes, Senator Taft repeated, cover "all the welfare purposes which are contained in any of the existing welfare funds now established in a certain number

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[52] 92 Cong. Rec. 5494.

[53] 92 Cong. Rec. 5930 (emphasis supplied).

[54] S. Rep. No. 105, 80th Cong., 1st Sess., 52 (Supplemental Views).

of industries."[55] All that is requisite is joint administration and specification of health and welfare purposes "— so much to provide health benefits, so much for this kind of hospital service, so much for this kind of insurance."[56] Funds may be freely established to furnish "definite services which are recognized as proper services for welfare funds."[57]

The upshot is clear. Congress drew no line between active and retired employees. It drew a line between health and welfare purposes and unrelated objectives. And within the health and welfare area it allowed full range. Since, in this case, the health benefits conferred are clearly within the authorized statutory purposes, and since no statutory distinction as to eligibility exists between retired and active employees, the legality of the conferment of health benefits upon retired employees is plain.

4. *The genesis in the Internal Revenue Code of the words "for the sole and exclusive benefit of employees" and of the requirement of separate maintenance of a pension fund:* It would be startling indeed if a benefit which is not within the evil at which Congress aimed, but is instead part of the positive good that Congress served, were nevertheless found to be prohibited by the words that Congress used. It is therefore not surprising to find that, in the light of the particularized history underlying the words chosen, they do not have the interdictory meaning ascribed to them. In the form in which it was finally enacted in 1947, section 302(c)(5) originated with an amendment introduced by Senator Ball on May 20, 1946.[58] It was this amendment which first used the words "for the sole and exclusive

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[55] 93 Cong. Rec. 4746.

[56] 93 Cong. Rec. 4747.

[57] *Ibid.*

[58] 92 Cong. Rec. 5277.

benefit of the employees." This amendment also contained a subpart (C) providing, as a condition of legality, that:

> Such payments meet the requirements for deduction by the employer under section 23(a) or section 23(p) of the Internal Revenue Code.

The words "for the sole and exclusive benefit of the employees" are exactly those which were finally enacted in 1947. Subpart (C) in its original form disappeared; the Senate bill as passed in 1947 contained no counterpart; but in conference a new version appeared, described as one of a number of "clarifying changes," [59] which was enacted and provides that:

> such payments as are intended to be used for the purpose of providing pensions or annuities for employees are made to a separate fund which provides that the funds held therein cannot be used for any purpose other than paying such pensions or annuities.

These changes "tie in, not unexpectedly, with those provisions of the Internal Revenue Code exempting qualified pension and welfare trusts from income taxation." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (April 23, 1965). Thus, concerning his amendment introduced in 1946, referring to deductibility under sections 23(a) and 23(p) of the Internal Revenue Code, Senator Ball stated:[60]

> Those are highly technical sections as I understand. Frankly, I do not know all the details of them. They provide the conditions under which business may deduct payments into a pension or other benefit plan for employees, from income for tax purposes. Certainly we should not expect the employer to make a contribution to a trust fund for the benefit of employees, and then force the employer to pay income tax on the amount of the contribution.

Senator Taft stated that:[61]

> In the first place, what about the tax situation? Can an employer pay money into the air on which no one is

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59 93 Cong. Rec. 6445.

60 92 Cong. Rec. 5346.

61 92 Cong. Rec. 5338.

> ever going to pay any tax? That question has not been considered. I may say there are many employers' trusts, mostly pension funds and health benefit funds set up by the employers, and under Federal law, section 23(p) and section 165 of the Internal Revenue Code, we have regulated them in detail because we recognized that such things may be abused by the employers. In this case it is obvious that the particular kind of fund may be abused by the union.

He further stated that:[62]

> The Byrd amendment carefully defines the recognized forms of health and welfare benefits which such funds have been used for, and which have been legislated about in the Internal Revenue Code, which are found to be funds for beneficial purposes, which should receive special tax exemption, and should have special consideration from the Government. That is what the Byrd amendment does.

Tracing section 302(c)(5) to the Internal Revenue Code casts revealing light on its scope. The words "for the sole and exclusive benefit of the employees" derived from section 165 of the Internal Revenue Code.[63] That section conferred tax-exempt status upon a "trust forming part of a stock bonus, pension, or profit-sharing plan of an employer *for the exclusive benefit of his employees* or their beneficiaries . . ." (emphasis supplied). The then applicable federal tax regulation made clear that "employees" meant either "present employees only, or present *and former employees, or only former employees*":[64]

> § 29.23(p)-1 *Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; in general.* [Emphasis in original.] Section 23(p) prescribes limitations upon deductions for amounts contributed by an employer un-

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[62] 92 Cong. Rec. 5494.

[63] 26 U.S.C. § 165 (1946 ed.). All references, unless otherwise indicated, are to the Internal Revenue Code in effect in 1946.

[64] Code of Federal Regulations, Cumulative Supplement, 1944, Title 26, Ch. I, § 29.23(p)-1 (emphasis supplied).

> der a pension, annuity, stock bonus, or profit sharing plan, or under any plan of deferred compensation. *It is immaterial whether the plan covers present employees only, or present and former employees, or only former employees.* Section 23(p) does not cover contributions which give the *employee or former employee* present benefits such as life insurance protection. The cost of such benefits in deductible to the extent allowable under this section 23(a). See § 29.165-6. [Emphasis supplied.]

Nor was the tax-exempt status of the pension fund affected by the coverage of former employees; as the federal tax regulations stated, "A plan is for the exclusive benefit of employees or their beneficiaries even though it may cover former employees as well as present employees and employees who are temporarily on leave, as, for example, in the military or naval forces."[65] Not only had the Internal Revenue Code "been administratively interpreted to include former employees" (*Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2042 (C.A. 8, April 23, 1965)), bnt the federal tax regulations made clear that it is not at all the retired employee at which the requirement of the exclusivity of pension benefits for the employee is aimed:[66]

> If the plan is so designed as to amount to a subterfuge for the distribution of profits to shareholders, even if other employees who are not shareholders are included under the plan, it will not qualify as a plan for the exclusive benefit of employees. The plan must benefit the employees in general, although it need not provide benefits for all of the employees. Among the employees to be benefited may be persons who are officers and shareholders. However, a plan is not for the exclusive benefit of employees in general if it discriminates either in eligibility requirements, contributions, or benefits by any device whatever in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other

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65 *Id.* § 29.165-1.

66 *Ibid.*

employees, or the highly compensated employees. See section 165(a)(3), (4), and (5).

Finally, since the tax-exempt status of a pension plan under section 165 of the Internal Revenue Code required that it be devoted solely to pension purposes, the necessary consequence was to compel separate maintenance of the pension trust. Accordingly, under the Code, a qualified pension trust was exempt from taxation (§ 165(a)); the distribution to the beneficiary was taxable only when he actually received it (§ 165(b)); and the employer's contribution to the pension fund was deductible as a business expense (§ 23(p)).

Thus, by the requirement of section 302(c)(5) of the Labor Relations Act, 1947, that a trust fund be established "for the sole and exclusive benefit of the employees" and that a pension fund be separately maintained, Congress guaranteed the maximum tax benefits available under the Internal Revenue Code. This special tax purpose also carried over to the health and welfare fund. The same tax advantage adhered to a health and welfare fund as to a pension fund. Tax-exempt status was conferred upon a health and welfare fund by section 101(16) of the Internal Revenue Code, which extended exemption to "Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents. . . ."[67] The term "member" of itself precluded a distinction between active or retired employees since either would be a member. The employer's contribution to the health and welfare fund was deductible as an "ordinary and necessary" business expense under section 23(a). And the contribution was deductible, as the federal tax regulation stated, whether the benefit inured to an "employee or former employee . . ." (*supra*, p. 32).

Since the Internal Revenue Code drew no distinction between active and retired employees, but treated both alike

[67] 26 U.S.C. § 101(16) (1946 ed.).

whether the benefits received were from a pension fund or a health and welfare fund, it is patent that the identical treatment is required under section 302(c)(5) which in presently pertinent part is based on the Internal Revenue Code. Thus, history shows that the very language relied on in section 302(c)(5) to show differentiation establishes identity when traced to its origin in the Internal Revenue Code. In short, the word "employee" when used in the Internal Revenue Code meant present and former employees; it did not acquire a different meaning when consciously transplanted to section 302(c)(5) for the very purpose of assuring identity in treatment. And the requirement of separate maintenance of a pension fund and a health and welfare fund which existed under the Internal Revenue Code did not mean, when transplanted to section 302(c)(5), that a pension fund can grant benefits to retired employees but a health and welfare fund cannot, when that was not the meaning of separateness under the Internal Revenue Code.

Except for a confirmatory change later discussed (*infra*, p. 37), the tax situation which existed in 1946 when section 302(c)(5) was initiated and in 1947 when it was enacted prevails as well today. A qualified pension fund and a health and welfare fund are both exempt from taxation by section 501(a) of the Internal Revenue Code of 1954. Tax-exempt status of a pension fund is governed by section 401, and of a health and welfare fund by section 501(c)(9). The employer's contribution to a health and welfare fund is tax deductible as an "ordinary and necessary" business expense under section 162(a);[68] the contribution to a pension fund is deductible by the employer under section 404; and the distribution from the pension fund is taxable to the beneficiary upon his receipt of it under section 402(a). Now as

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[68] 1 Federal Tax Regulations § 1.162-10(a) (1964) states that: "Amounts paid or accrued within the taxable year for dismissal wages, unemployment benefits, guaranteed annual wages, vacations, or a sickness, accident, hospitalization, medical expense, recreational, or similar benefit plan, are deductible under section 162(a) if they are ordinary and necessary expenses of the trade or business."

then, the federal tax regulations state that a pension plan "is for the exclusive benefit of employees or their beneficiaries even though it may cover former employees as well as present employees and employees who are temporarily on leave, as, for example, in the Armed Forces of the United States";[69] now as then, in determining the tax deductibility of the employer's contribution, "It is immaterial whether the plan covers present employees only, or present and former employees, or only former employees";[70] now as then, the requirement that a pension fund be for the exclusive benefit of employees is aimed at the "subterfuge" by which the fund would be used to discriminate in favor of shareholders, officers, supervisors, or highly compensated employees.[71]

The upshot is clear. As the words "for the exclusive benefit of his employees" in the Internal Revenue Code do not bar retired employees, neither do the words "for the sole and exclusive benefit of the employees" in section 302(c)(5) bar retired employees, in view of the genesis of the 302(c)(5) words in the Internal Revenue Code. Furthermore, tax exempt status of a welfare fund is unaffected by the grant of benefits to retired employees.[72] To repeat, therefore, the words of Senator Taft, "The Byrd amendment carefully defines the recognized forms of health and welfare benefits which such funds have been used for, and which have been legislated about in the Internal Revenue Code, which are found to be funds for beneficial purposes, which should receive special tax exemption, and should have special consideration from the Government. That is what the Byrd amendment does."[73] It would be a queer sort of

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[69] 1 Federal Tax Regulations § 1.401-1(b)(4) (1964).

[70] Id., § 1.404(a)-1 (a).

[71] Id., § 1.401-1(b)(3).

[72] Opinion Letter, Director, Tax Rulings Division, June 27, 1963, reproduced in Appendix, *infra*, pp. 65-66.

[73] 92 Cong. Rec. 5494.

"special consideration from the Government" to invalidate tax-exempt funds for "beneficial purposes."

5. *The expansion of permitted purposes in 1959:* In 1959, Congress amended section 302(c) of the Labor Management Relations Act, 1947, to add that a jointly administered trust fund could be established "for the purpose of pooled vacation, holiday, severance or similar benefits, or defraying costs of apprenticeship or other training programs."[74] This amendment was adopted to allay "a doubt as to the legality of employer contributions to joint trust funds" for such purposes.[75] It was designed to overcome restrictive judicial interpretation of the purposes permitted by section 302(c) "in order that courts will not strike down, as illegal, labor and management agreements . . . which promote harmony in an industry and redound to the benefit of employer and employee alike."[76] It is to the last degree unimaginable that, in the face of explicit expansion of permitted purposes to remove doubt as to the legality of "pooled vacation, holiday, severance or similar benefits, or . . . apprenticeship or other training programs," Congress thought that it had in 1947 enacted, or in 1959 would have continued, a prohibition against health benefits for retired employees. *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2042 (C.A. 8, April 23, 1965).

D. Related Statutes Show That Congress Did Not by Section 302(c)(5) Intend to Bar Health Benefits for Retired Employees.

Other federal enactments dealing with health benefits for the retired employee show the solicitude of Congress for him and the untenability of imputing to Congress any intention that section 302(c)(5) shall preclude the grant of health benefits to him. And of course, in striving for in-

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[74] 29 U.S.C. § 186, 73 Stat. 537 (1959).

[75] H. Rep. No. 741, 86th Cong., 1st Sess., 23; 105 Cong. Rec. 886.

[76] *South Louisiana Chapter* v. *International Brotherhood of Electrical Workers, Local Union 130*, 177 F. Supp. 432, 437 (E.D. La.).

formed interpretation, courts "look at later statutes 'considered to throw a cross light' upon an earlier enactment."[77]

1. The 1962 amendment of section 401 of the Internal Revenue Code of 1954.

Until 1962, in order to maintain its tax-exempt status, a pension fund could not be combined with a health and welfare fund. On October 23, 1962, Congress amended Section 401 of the Internal Revenue Code of 1954, related to qualified pension, profit-sharing and stock bonus plans, to provide that a single fund within prescribed limits could grant both pension and health benefits to retired employees and still enjoy tax-exempt status:[78]

> Under regulations prescribed by the Secretary or his delegate, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and their dependents, but only if—
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> (1) such benefits are subordinate to the retirement benefits provided by the plan,
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> (2) a separate account is established and maintained for such benefits,
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> (3) the employer's contributions to such separate account are reasonable and ascertainable,
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> (4) it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits, and
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> (5) notwithstanding the provisions of subsection (a) (2), upon the satisfaction of all liabilities un-

[77] Frankfurter, Reflections on Reading Statutes, in Westin, The Supreme Court: Views from Inside, 90 (1961). *E.g., N.L.R.B.* v. *Drivers Local Union No. 639*, 362 U.S. 274, 291-292.

[78] 26 U.S.C. § 401(h), 76 Stat. 1141 (1962).

> der the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer.

Explaining this amendment, the Conference Report stated that it "would allow a pension or annuity plan, qualified under the Internal Revenue Code of 1954, to provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees and their spouses and dependents, if such benefits are subordinate to the retirement benefits provided by the plan. It would make it possible for an employer, where he chooses to do so, to provide these benefits through a qualified pension or annuity plan, rather than being required to do so separately, as under existing law." [79]

The explanations on the House and Senate floors are instructive. Congressman Byrnes, one of the managers upon the part of the House, stated that:[80]

> . . . H.R. 10117 would allow an employer to provide for the payment of benefits for accident and health expenses to retired employees, their spouses, and dependents under a pension plan qualified under the Internal Revenue Act of 1954. Under existing law an employer wishing to provide such benefits must do so under a separate plan. Under no circumstances can he combine a pension plan with an accident and health plan. Obviously, this adds to the administration of such plans.
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> Pension plans and accident and health plans are becoming quite common in industry. They are essential if we are to adequately provide for the retired worker through the private sector of the economy. Otherwise, he will become increasingly dependent on Government. The worker earns the benefits he receives under these plans. They are not handouts from the Federal Govern-

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[79] H. Conf. Rep. No. 2555, 87th Cong., 2d Sess., in 2 U.S. Cong. & Adm. News 3934 (1962).

[80] 108 Cong. Rec. 19090.

ment, and, therefore, enable him to maintain his self-respect and dignity. We have heard too much talk lately about the Government assuming more and more responsibility in this area.

Any loss in Federal revenue under this bill would be insignificant, if not negligible. The cost of both types of plans are now deductible by the employer, and is not considered income to the employee. The bill merely enables the employer to consolidate the two into one.

This should have a desirable effect on the growth of both pension plans and accident and health plans. . . .

Congressman Curtis stated:[81]

I rise today to support a bill, H. R. 10117, which I have introduced whose purpose is to clear away a legislative obstruction to the further progress of our private enterprise institutions in meeting the needs of our people in this area.

* * *

The obstruction of which I speak is the present language of section 401. At present, pension plans cannot fund for health insurance for their beneficiaries. Indeed if they do they endanger their tax-exempt status. Through the growth of pension funds—they contain some $50 billion and cover some 15 million workers—there exists an important vehicle for providing many millions of our retired workers with the means to pay their health care costs. Removing the current obstruction, great progress in this area is possible.

The importance of this proposal must be seen in the light of the related progress in the overall health care field, especially in the dramatic advances in health insurance. Prepayment—that is payment for health care benefits after 65 during one's working years—and noncancellable insurance are now recognized features of available policies. Labor-management agreements are getting more and more into the field, as workers seek health care protection not only for their working years but for their retirement years as well. This proposal

81 *Ibid.;* see also 108 Cong. Rec. 19089 (Congressman Mills).

> fits into this movement and the progress of one can assist the progress of the other. . . .
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> * * *
>
> This bill is not offered as a final solution to all the problems in this important area of health care; rather it is offered as one constructive step forward in strengthening the private enterprise system's ability to meet the problem. . . .

And Senator Byrd, who initiated trust fund regulation in 1946 which eventuated in the enactment of section 302(c)(5) of the Labor Management Relations Act, 1947, stated that:[82]

> . . . H. R. 10117 relates to the qualifications of certain pension trusts under the Internal Revenue Code. Under existing Treasury regulations, a qualified pension trust may not include benefits for sickness, accident, hospitalization or medical expenses for retired employees and retain qualification for income tax exemption or for deductibility of employer contributions made under the retirement plan.
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> On the other hand, the existing law permits contributions under accident and health plans for employees to be deducted by employers and excluded from gross income of employees.
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> H. R. 10117 would eliminate the prohibitions against qualified pension trusts including sickness, accident, hospitalization or medical benefits for their beneficiaries. It would permit these benefits and pension benefits to be funded together under a single trust provided separate accounts are kept—so the contribution for the sickness, et cetera, benefits can be ascertained —and provided the sickness, et cetera, benefits are subordinate to the pension benefits.
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> . . . Revenue effects would be negligible because the bill primarily simplifies administration of plans for medical benefits and for pension benefits by making separate trusts unnecessary.

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[82] 108 Cong. Rec. 22539.

The 1962 amendment conclusively confirms that the separateness of a pension fund from a health and welfare fund under the Internal Revenue Code, and the consequent related separateness of the two under section 302(c)(5) of the Labor Management Relations Act, 1947, was never intended to preclude the grant of health benefits to retired employees. Abolition of compulsory separateness under the Internal Revenue Code was designed to facilitate the extension of health benefits on retirement. While that particular means of facilitation cannot apply to a jointly administered trust fund, because of the continuing bar against combination independently contained in section 302(c)(5), the universal acceptance in Congress of the desirability of health benefits on retirement precludes the view that by section 302(c)(5) Congress had made this good totally unavailable to the worker in an industry in which joint administration prevails. As Congressman Curtis noted, "Labor-management agreements are getting more and more into this field, as workers seek health care protection not only for their working years but for their retirement years as well" (*supra*, p. 39). It was never suggested that the benefits available through collective bargaining are different based on whether joint administration or sole employer administration is the agreed method of handling. It would come as a shocking surprise to Congress to learn that it had forbidden health benefits on retirement in the coal industry, because joint administration exists there, but had permitted it in the steel industry, because joint administration does not exist there. Congress drew no line between the coal miner and the steel worker.

2. Federal Employees Health Benefits Act of 1959; Retired Federal Employees Health Benefits Act.

On September 28, 1959, Congress enacted the Federal Employees Health Benefits Act of 1959.[83] This statute extended health benefits to federal employees in active service

[83] 5 U.S.C. § 3001, 73 Stat. 708 (1959).

to be continued on their behalf on retirement. On September 8, 1960, Congress enacted the Retired Federal Employees Health Benefits Act.[84] This statute extended health benefits to already retired federal employees whose active service had ceased at a time when no health benefits were available for either active or retired employees. In combination the two statutes granted health benefits to all federal employees whether active or retired.

The provision for health benefits in the federal service was based on the fact that the grant of these benefits to active and retired employees was commonplace in private industry.[85] "At the present time, a wide gap exists between the Government, in its capacity as employer, and employers in private industry, with respect to health benefits for employees. Enlightened, progressive private enterprise almost universally has been establishing and operating contributory health benefits programs for its employees. Until now, the Government has made scant progress in this area. This bill is designed to close the gap which now exists and bring the Government abreast of most private employers."[86] Strong approval was uniformly expressed on the floors of the House and Senate for the extension to active and retired

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[84] 5 U.S.C. § 3051, 74 Stat. 849 (1960).

[85] Hearings, Senate Subcommittee on Post Office and Civil Service, on S. 94, 86th Cong., 1st Sess., 83, 186-187, 257-258, 296-297, 310-312 (1959); Hearings, House Committee on Post Office and Civil Service, on S. 2162, 86th Cong., 1st Sess., 51, 292-293, 359 (1959); Hearings, Senate Committee on Post Office and Civil Service, on S. 2575, 86th Cong., 1st Sess., 18, 22, 24-25, 31, 34, 41 (1959); Hearings, House Committee on Post Office and Civil Service, on S. 2575, 86th Cong., 2d Sess., 24 (1960). A study prepared by the Bureau of Labor Statistics at the request of the Bureau of the Budget to assist it and the Congress in considering the extension of health benefits to retired federal employees shows that: "When 112 major collectively bargained health and insurance plans made provision for extension of health benefits to workers upon retirement, two-thirds (76) also extended coverage to employees who had already retired." Landay, *Extension of Health Benefits to Prior Pensioners*, 83 Monthly Lab. Rev. 841 (1960).

[86] H. Rep. No. 957, 86th Cong., 1st Sess., in 2 U.S. Cong. & Adm. News 2914 (1959).

federal employees of the same health benefits already enjoyed by active and retired employees in the private sector of the economy.[87] The bill "does for Federal employees no more than is being done for millions of private employees";[88] "Private industry has long had health coverage plans for its employees and it is time that the Federal Government, the nation's largest employer, provide equal benefits in this respect";[89] "Not to give the Federal employees the same kind of health insurance opportunities and health benefits which are available in the best plans for private employees is . . . both unsound from the point of view of national justice and unwise in terms of making certain that the Government has an opportunity to recruit a very high level of Federal employees";[90] "The Federal employees . . . definitely need a program which will provide them with health insurance benefits during their active service with the Government and after their retirement."[91]

In extending in 1959 health benefits to active federal employees and providing for their continuation on retirement, the single but repeated expression of regret was that the same health benefits had not also been extended to already retired federal employees, and the reiterated promise was that this deficiency would be cured in the next session.[92] "This group of loyal retired federal employees has not been forgotten . . .";[93] " 'We consider it essential that legislation for active and future retirees be supplemented in the near future by providing similar benefits for those already re-

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87 105 Cong. Rec. 13562-13564, 13568, 16861, 16862, 17553, 17555-17561; 106 Cong. Rec. 17078-17079.

88 105 Cong. Rec. 13562.

89 *Ibid.*

90 105 Cong. Rec. 13563.

91 105 Cong. Rec. 17556.

92 105 Cong. Rec. 13562, 13564, 13565, 13568, 17560, 17561.

93 105 Cong. Rec. 13562.

tired.' '' [94] The promise was kept in 1960. Congress met its "clear obligation . . . to provide equal treatment, in terms of health and medical benefits, for those loyal former employees who completed their service and earned their retirement before becoming eligible for such benefits under Public Law 86-382." [95] "The Federal Government cannot ignore the progressive examples of many large private employers who sponsor health benefit programs and have included in these programs persons already retired";[96] "We recognize that for the 415,000 retirees who will benefit from this act, that we are doing in large measure what many private industries have done for their employees, and we hope others will do the same." [97]

It is totally inconceivable that Congress, while looking to private employment for its own example in extending health benefits to federal employees on retirement, should have imputed to it an intention to bar granting health benefits to retired employees who work in that sector of the private economy which is governed by section 302(c)(5). The anomoly is glaringly accentuated by the probability that a good part of the experience in private employment which impressed Congress had been furnished by health benefits plans under joint administration. The solicitude of Congress for the retired employees, whether public or private, did not stop short at section 302(c)(5).

E. The Method of Financing Health Benefits for the Retired Employees Is Not Relevant to the Validity of Their Coverage.

Under the plan in this case, benefits paid by the medical-hospitalization trust fund are financed by contributions to the fund from each employer at an hourly rate for each

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94 105 Cong. Rec. 17561.

95 H. Rep. No. 1930, 86th Cong., 2d Sess., in 2 U.S. Cong. & Adm. News 3436 (1960).

96 105 Cong. Rec. 16861.

97 106 Cong. Rec. 17078.

hour of work performed for the particular employer by his employees; contributions were "at the rate of 12¢ per hour per man during 1962 and 1963 and 15¢ per hour during 1964."[98] The benefits paid are therefore cost-free to the employee, whether active or retired. This is thus a fairly typical plan in which the cost is financed solely by the employers rather than shared by the employees.

The District Court found that "the benefits presently paid to the retirees and their wives are provided for by extra assessments now being paid by the employers and not out of surplus contributions which accumulated during the time the former employees were actively employed" (58 LRRM 2692). By "extra assessments" the District Court presumably means that the hourly rate of contributions was set at a higher figure in order to furnish the wherewithal for defraying from current income the expense of paying benefits to the retired employees. Since part of the current contribution was used to finance the benefits for the retired employees, the District Court found that the employers' payment was illegal based on its fundamental conclusion that retired "persons are no longer employees," and therefore that the employers' payment was not "for the sole and exclusive benefit of the employees . . ." (58 LRRM at 2692). As that conclusion is untenable, and retired employees are within the authorized coverage of a jointly administered welfare fund, the District Court's concern with the method of financing the benefits received by the retired employees is irrelevant.

Insofar as section 302(c)(5) is concerned, in addition to payments to the trust by the employer, contributions may be received by the trust "from the employee, active or retired, or from another source in his behalf. . . ." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (C.A. 8, April 23,

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[98] Plaintiff's brief in the District Court, p. 8. We disregard as irrelevant for present purposes the monthly amount paid on behalf of associate employees (*supra*, p. 3).

1965). The sole requirement prescribed by section 302(c)(5) with respect to the source of contributions to the fund is that, as to the employer's contributions, "(B) the detailed basis on which such payments are to be made is specified in a written agreement with the employer. . . ." This requirement "is obviously directed only to the collective bargaining employer's payments and not to such supplemental ones." *Blassie* v. *Kroger Co., supra*, at 2041. Accordingly, while the employer's basis of payment must be detailed in an agreement with him, the method of financing the cost of a welfare plan—how much shall be paid by whom—is a matter determined by collective bargaining.

Thus, in *Blassie* v. *Kroger Co., supra*, at 2038, reversing, 225 F. Supp. 300, 306-307, the cost of the benefits for the retired employees was shared by the retired employees and the welfare fund. Since the fund's only source of income (other than the retired employees' own contribution) was payments received from employers, it is clear that the benefits for the retired employees were partly financed by the employers. And since the share paid by each retired employee was ten dollars per month (raised from 5 dollars per month), in contrast with the $31.70 per month paid by the contributing employers for each active employee who averaged 23 or more hours of work per week for the month, it is also clear that the employers' contributions financed the major part of the benefits for the retired employees. In *Local 688, Teamsters* v. *Townsend*, 59 LRRM 2048 (C.A. 8, April 23, 1965), reversing, 229 F. Supp. 417, 418, the benefits to be paid to the employees after retirement were financed by contributions from the employers in the amount of two cents for each hour of basic wage paid to the active employees.

The plans in this case, *Blassie* v. *Kroger Co.*, and *Local 688, Teamsters* v. *Townsend* illustrate the variety of collectively-bargained methods of financing benefits for re-

tired employees. The cost may be borne wholly by the employer, shared with the retired worker, or borne wholly by the retired worker. Even where the cost is wholly financed by the retired worker, the group coverage gives him the advantages of lower premiums, the absence of medical, age, and other restrictions on coverage, and the rarity of contract cancellations. The lower rate results from averaging the cost of providing benefits for the active and retired employees, and is particularly advantageous to the retired employees because the active workers, being on the whole much younger, have lower utilization rates than the retired workers. The method of financing may alter with the employee's change from active to retired status. On retirement the employer may assume the full cost of benefits theretofore jointly-financed or *vice versa,* and the amount of the contribution may change.[99]

The methods of financing are thus quite variegated. Collective bargaining shapes them to the form suitable for the particular industrial community. And, so long as the basis of the employer's contribution is detailed in an agreement with him, the form the financing takes is irrelevant under the terms of section 302(c).

F. Summary

Accordingly, the text of section 302(c)(5), its particular legislative history, the general legislative milieu enveloping the problem, and public policy combine to require the conclusion that an employee on retirement is eligible to continue to receive health benefits from a jointly administered trust fund. No good reason has been suggested, and none exists, to suppose that Congress, while allowing the payment of pensions on retirement, precluded the grant

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[99] The statements in this paragraph are based on Bull. No. 1280, *op. cit. supra,* p. 14, n. 7, at 8-11; Bull. No. 1274, *op. cit. supra,* p. 14, n. 7, at 6-9; Bull No. 1296, *op. cit. supra,* p. 14, n. 7, at 3-4; Bull. No. 1293, *op. cit. supra,* p. 14, n. 7, at 6-7.

of health benefits on retirement. Responsive to the realities of the economic situation the common law developed the rule that a worker on strike retained his employee status.[100] The same response to economic reality requires the conclusion that for the purpose of pension and health benefits the term "employee" means an active or retired employee. "The range of judicial inventiveness will be determined by the nature of the problem."[101] The term "employee" has traditionally been molded to fit the particular problem. What it means "must be answered primarily from the history, terms and purposes of the legislation. The word 'is not treated by Congress as a word of art having a definite meaning. . . .' Rather 'it takes color from its surroundings . . . [in] the statute where it appears' . . . , and derives meaning from the context of that statute, which 'must be read in the light of the mischief to be corrected and the end to be attained.' "[102] Given that orientation, the conclusion is clear that section 302(c)(5) does not bar retired employees from receiving health benefits. "There is no good reason . . . to restrict the term 'employee' sought to be done in this case. That term, like other provisions, must be understood with reference to the purpose of the Act and the facts involved in the economic relationship. Where all the conditions of the relation require protection, protection ought to be given."[103] "Any plan for the health and economic well-being of employees, whether it be one gratuitously granted or one hammered out by hard bargaining, would normally be expected to embrace the crises of unemployment, retirement, and disability, as well as those of the better times of active employment. An opposite result, with benefits available only when the weather is fair and the needs are less,

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100 *Jeffery-DeWitt Insulator Co.* v. *N.L.R.B.*, 91 F.2d 134, 136-138 (C.A. 4).

101 *Textile Workers Union* v. *Lincoln Mills*, 353 U.S. 448, 457.

102 *N.L.R.B.* v. *Hearst Publications*, 322 U.S. 111, 124.

103 *Id.* at 129.

would be ironical in application and, we feel, should not be reached without a clearer indication of congressional intent than we have here." *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2041 (C.A. 8, April 23, 1965).

II. SECTION 302(c)(5) OF THE LABOR MANAGEMENT RELATIONS ACT, 1947, DOES NOT BAR EMPLOYEES AND OFFICERS OF THE CONTRACTING UNION FROM COVERAGE AS BENEFICIARIES OF A JOINTLY ADMINISTERED PLAN.

We shall show, as the Court of Appeals for the Eighth Circuit held, that section 302(c)(5) of the Labor Management Relations Act, 1947, does not bar participation by employees and officers of the contracting union as beneficiaries of a jointly administered trust fund. *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2044-45.

A. The Extension of Benefits to Employees and Officers of the Contracting Union is Squarely Within the Text of Section 302(c)(5).

The contracting union is of course a distinct entity with the status of an employer vis-a-vis its own employees. This conclusion is indeed compelled by statutory definition. Section 2(2) of the National Labor Relations Act defines the term "employer" to include any labor organization "when acting as an employer." That definition is made applicable to section 302(c)(5) by section 501(3) of the Labor Management Relations Act, 1947. Accordingly, as with the National Labor Relations Act, so with section 302(c)(5), "It follows that when a labor union takes on the role of an employer the Act applies to its operations just as it would to any other employer." *Office Employes International Union, Local No. 11* v. *N.L.R.B.*, 353 U.S. 313, 316. And this conclusion is in keeping with the policy of Congress that "'In its relations with its own employees, a labor organization ought to be treated as an employer. . . .'" *Id.* at 318.

As the contracting union is an employer, coverage of its employees and officers as beneficiaries of the medical-hospitalization and pension funds is squarely within the terms of section 302(c)(5). That section explicitly states that different employers may contribute to a single trust fund. Thus, payment may be made to a fund by an employer not only "for the sole and exclusive benefit of the employees of such employer" but also for them "jointly with other employers making similar payments. . . ." As a separate and distinct employer, the union is therefore precisely within the class of "other employers" eligible to make "similar payments" for their employees who participate "jointly" with other employees.

Payment by a contracting union as an employer to a jointly administered trust fund for its employees and officers "thus fits the technical structure" of section 302(c)(5) precisely. *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2043, 2044, 2045 (C.A. 8, April 23, 1965). The District Court in this case therefore indulges the sheerest *ipse dixit* when it states that the statutory term "employer" does not cover "the union in its capacity as an employer of its own personnel," and that "Congress was not concerned, in this legislation, with the well being of employees looking to the union for their compensation" (58 LRRM at 2691). That conclusion does violence to the text and is unsupported by either statutory purpose or history.

B. The Extension of Benefits to Employees and Officers of the Contracting Union is Outside the Substantive Evil Against Which Section 302(c)(5) is Aimed, and is Consistent With the Procedural Means Adopted by Section 302(c)(5) to Prevent Realization of the Substantive Evil.

Employees and officers of a union, no less than any other class of employees, need health, welfare, and pension benefits. The grant of these benefits to them, as to any other employees, partakes of no evil against which section 302(c)(5) is directed but is instead part of the positive good it serves.

To suggest a substantive evil, the specter has been invoked that to allow a union in its capacity as an employer to participate in a jointly administered fund "would be to give union leaders an *opportunity* to funnel welfare benefits to union employees at the union leaders' discretion." *Kroger Co.* v. *Blassie,* 225 F. Supp. 300, 310 (E.D. Mo.) (emphasis in original). In reversing, the Court of Appeals for the Eighth Circuit gave this chimera short shrift. "We see no particularized danger of abuse. Payments are made to a jointly administered fund. There is present only the same possibility of abuse which is at hand when any trustee or group of trustees chooses to be dishonest." *Blassie* v. *Kroger Co.,* 59 LRRM 2034, 2043-44. A dishonest trustee wont to give unauthorized benefits is not confined to union employees or officers as the recipients of his impermissible largesse. As to any of the beneficiaries of a fund it can with equal merit be said that "an *opportunity*" exists "to funnel" benefits to them "at the union leaders' discretion." Among the members employed by a company contributing to the fund may be those who have such substantial political influence within the contracting union as to make them far likelier recipients of unauthorized largesse than a union bookkeeper or typist. This line, therefore, leads to the conclusion that *no* employees should be beneficiaries of a jointly administered trust fund and that Congress was mistaken in enacting section 302(c)(5) at all.

The line is patently misdirected. Risk of abuse is inherent and inescapable whether the fiduciary is a bank, a corporate officer, a lawyer, or anyone else. It is necessary to paint with a finer brush. The employee and officer of the contracting union is no less an "employee" than is the employee of any contributing company. The two cannot be distinguished by the possibility of abuse since this inheres in the coverage of either. The requirement which does not obtain is that the same standards of payment, eligibility, and benefits apply to both. If, in administer-

ing an even-handed standard, a union employee or officer is unjustly favored, the remedy is to curb that particularized abuse, not to ban the whole class as outlaws.[104] It would be a wholly unnatural state of affairs, and therefore is a wholly artificial reading the statute, to exclude from the benefits of the fund the employees of the contracting union who serve the interests of all the employees and should therefore be expected to share the same employment benefits with them.

Furthermore, the participation of the contracting union in the fund as an employer is entirely consistent with the procedural means embraced in section 302(c)(5) to prevent realization of the substantive evil. As stated, the means adopted by Congress was to define the purposes for which the fund could be established, to require that the benefits payable be specified in detail in the trust agreement, and to prescribe joint union-employer administration of the fund (*supra,* p. 24).

Coverage of union employees and officers presents no problems of compatibility with the defined purposes or of particularization of the benefits in the trust agreement. Nor does it offend the statutory requirement of equal representation of employees and employers in the administration of the fund. It is too plain for anything but statement that of course the contracting union may have no voice in choosing the employer representatives. But the consequence of this disability is, not that it is not an employer within the meaning of section 302(c)(5) for the purpose of its own employees, but that its status as an employer does not extend to its participation in the selection of employer representatives, and this for the simple reason that in view of its dominating characteristic as an employee representative it would do violence to the principal of equal representation were it to share in the selection of the employer representatives.

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104 See, *Upholsterers' International Union* v. *Leathercraft Furniture Co.*, 82 F. Supp. 570, 575 (E.D. Pa.).

The union occupies a dual role, an employer for one purpose and an employee representative for another, and all that is necessary is an accommodation of the two roles, not the destruction of one in order to be sure that it does not intrude into the other. An obligatory "either or reading of the statute," with no range for adjustment of the parts, has nothing to commend it but "a bit of verbal logic from which the meaning of things has evaporated."[105] It is essential to sound interpretation to abjure a purely verbal dilemma. "All rights tend to declare themselves absolute to their logical extreme. Yet all in fact are limited by the neighborhood of principles of policy which are other than those on which the particular right is founded, and which become strong enough to hold their own when a certain point is reached."[106] One principle of policy is that a union is an employer vis-a-vis its own employees. The other principle of policy is equal representation in the administration of a trust fund. The first principle is fulfilled by allowing the union employees and officers to be beneficiaries of the fund. The second principle is respected by excluding the union from participating in the selection of the employer representatives. Each principle is accommodated without injury to either and with the greatest good to all.

The nonparticipation by the union in the selection of the employer representatives comes by command of the statute, not by grace of contract. The Union "is entitled to no voice in the selection of employer trustees. This is a matter of absence of right by the terms of the statute; it is not something which can be affected by contract. Of course, the union is in a dual position, that of employer of its employees, and that of basic union status with respect to the contributing employers. But this dualism of position is not irreconcilable with the statute and the functioning of a § 302(c)(5) trust." *Blassie* v. *Kroger*

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105 *Phelps Dodge Corp.* v. *N.L.R.B.*, 313 U.S. 177, 190-191.

106 *Hudson County Water Co.* v. *McCarter*, 209 U.S. 349, 355.

Co., 59 LRRM 2034, 2044 (C.A. 8, April 23, 1965). See also, *Local No. 688, Teamsters* v. *Townsend*, 59 LRRM 2048 (C.A. 8, April 23, 1965).

The Court of Appeals for the Eighth Circuit thus rejected the inflexibility of the decision in *Local No. 688, Teamsters* v. *Townsend*, 229 F. Supp. 417 (E.D. Mo.), which it reversed, 59 LRRM 2048. The District Court in that case had stated its disbelief that "the union employee can be brought under the Trust simply by providing in the agreement that the union employee's employer cannot participate in the selection of the employer trustees. The statute provides that they have that right if they are employers, and the court is of the opinion that it cannot be circumvented by agreement." 229 F. Supp. at 421. Thus, the District Court had inexorably imputed a "right" to the union as an employer, gave the "right" such implacability that relinquishment of it by agreement was deemed circumvention, and all for the purpose of establishing that the union could have no status as an employer to which the "right" could attach. Solemnly to intone that a self-defeating "right" cannot be relinquished by agreement, instead of reading the agreement as contractual affirmation of the statutory principle of equal representation, is to demonstrate again that "the word 'right' is one of the most deceptive of pitfalls; it is so easy to slip from a qualified meaning in the premise to an unqualified one in the conclusion."[107] The only relevant right is that the employers shall have equal representation in the administration of the trust fund, and observance of that right requires that the union shall not in any capacity participate in the selection of employer representatives. When that right is respected, there is no additional right which demands that the union employees and officers shall not be beneficiaries of the trust.

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[107] *American Bank & Trust Co.* v. *Federal Reserve Bank of Atlanta*, 256 U.S. 350, 358.

C. No Basis Exists for Distinguishing Between Union Employees and Officers so as to Allow Union Employees but Not Union Officers to Participate as Beneficiaries of a Jointly Administered Trust Fund.

It has been suggested that a basis exists for statutorily barring union officers from participating as beneficiaries of a jointly administered trust fund which does not apply to union employees. According to the District Court for the Eastern District of Missouri, while a union is the employer of its "clerks, secretaries, and the like," it is not "an employer of its officers. If officers were considered employees of the union, and if such officers would organize themselves and bargain with their employer-union, a situation would exist where such officers would be bargaining with themselves. Such a situation would be untenable." *Kroger Co.* v. *Blassie,* 225 F. Supp. 300, 309. In reversing, the Court of Appeals for the Eighth Circuit observed that (*Blassie* v. *Kroger Co.,* 59 LRRM 2034, 2045):

> An officer of a union is an employee of that union just as the president of a corporation is its employee. He is no less an employee for the purposes of a jointly administered fund under § 302(c)(5) because he may also possess managerial capacity and not be in a position to bargain collectively with his own union as his employer. The right collectively to bargain is an entirely different question. Section 302(c)(5) speaks only of "the employees" of an employer. It draws no distinction among employees. We have noted before that the statute has a relationship with existing Internal Revenue Code provisions and we now note further that these code provisions, § 165(a)(3)(B) and (4) of the 1939 Code and § 401(a)(3)(B) and (4) of the 1954 Code, permit the inclusion of officers and supervisors if there is no discrimination in their favor.

> The considerations which we have found persuasive with respect to trust employees and non-officer union employees have application here. Again, we see no danger of special opportunity for abuse and we deem it natural, and not unexpected, that union officers be able to qualify for benefits no more favorable than those available to other beneficiaries.

To begin with, whether union officers may "organize themselves and bargain with their employer-union" is a question not germane to the interpretation of section 302(c)(5). For the premise that particular union officers may not combine to bargain collectively does not support the conclusion that the union is not their employer. Some one must be their employer and there is no one but the union. The presidents and vice-presidents of every contributing company have that company as their employer. Union officers are in no different position.

It may be that the high rank of particular officers, corporate or union, so allies them with their employer as to constitute them managerial employees precluded from bargaining collectively on their own behalf through a representative of their own choosing. But this preclusion exists, not because they have no employer, but because they have a particular relationship to their employer which renders collective bargaining inappropriate. And this relationship is not determined merely by the designation "officer," but requires a detailed consideration of the actual duties, status, and responsibility of each individual, for the title "officer" ranges from the ceremonial to effective executive direction. Thus the National Labor Relations Board has found, vis-a-vis a union as an employer, a unit appropriate for collective bargaining composed of "All International representatives on the payroll of the Textile Workers Union of America . . . who serve as joint board managers (also referred to as business managers and as joint board directors), business agents, administra-

tive personnel, administrative assistants to industry directors, and organizers. . . .''[108]

It is therefore simply mistaken to say that a union is not the employer of its officers. All that can be said is that particular union officers, based on their particular status, may not bargain collectively with their employer. And this specialized situation, pertinent to the appropriateness of collective bargaining, is wholly irrelevant to the instant issue, namely, whether union officers as a class are ineligible by virtue of section 302(c)(5) to participate as beneficiaries of a jointly administered trust fund. That particular union officers may not be free to bargain collectively for themselves has nothing to do with debarring the class from eligibility as trust fund beneficiaries. Different considerations, to which we now turn, govern this question.

The precise relevant words of section 302(c)(5) are that money paid by an employer to a trust fund shall be ''for the sole and exclusive benefit of the employees of such employer. . . .'' The quoted words, as we have seen (*supra,* p. 31), were drawn directly from the Internal Revenue Code. And the Code was explicit that officers may be included as beneficiaries of a trust. All that was requisite to inclusion of officers was that, in qualifications, contributions, and benefits, the plan shall ''not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees. . . .''[109] As the federal tax regulations stated, ''Among the employees to be benefited may be persons who are officers and shareholders'' (*supra*, p. 32). The plan failed to be ''for

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[108] *Textile Workers Union of America,* 138 NLRB 269; see also, *American Federation of Labor-Congress of Industrial Organizations,* 120 NLRB 969; *International Ladies' Garment Workers' Union,* 131 NLRB 111, 142 NLRB 353, affirmed as to the NLRB's decision that business agents were not managerial employees, 339 F.2d 116 (C.A. 2). *Cf. Federation of Union Representatives* v. *N.L.R.B.,* 339 F.2d 126 (C.A. 2).

[109] 26 U.S.C. § 165(a)(3)(B) and (4) (1946 ed.).

the exclusive benefit of employees'' only if it was a ''subterfuge for the distribution of profits to shareholders,'' or ''if it discriminate[d] either in eligibility requirements, contributions or benefits by any device whatever in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees'' (*supra*, p. 32). And this remains the situation under the Internal Revenue Code today.[110]

Accordingly, relating the words of section 302(c)(5) to their origin in the Internal Revenue Code, it is clear that officers are employees, and that a plan ceases to be for the exclusive benefit of employees only if it discriminates in favor of officers. This conclusion is particularly fitting in the case of union officers. For, having negotiated a plan on behalf of the employees they represent, it is natural that they should share its benefits on an evenhanded basis. Indeed, many officers, but for their election and service as officers, would be working at the trade and enjoying the benefits of the plan. Union service should not be the occasion for depriving them of the benefits they would have were they working at the trade. This is not, as the District Court in this case would have it, the expression of a ''political theory'' unrelated to the ''intent of Congress'' (58 LRRM at 2692). The intent of Congress cannot be faithfully ascertained by tearing the statute from its environment and disregarding the consequences of its operation within the milieu of its particular application.

In short, whatever its duty to bargain collectively with a representative of particular officers in its employ, the union remains the employer of all its officers. As an employer, the union may contribute to a jointly administered trust fund on behalf of its employee-officers, and they are

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[110] Internal Revenue Code of 1954, § 401(a)(3)(B) and (4); 1 Federal Tax Regulations § 1.401-1(b)(3) (1964).

eligible to be beneficiaries, subject only to the requirement that the plan shall not discriminate in their favor.

D. The "Possibility of Conflict of Interest" Between Its Role as a Labor Organization and Its Position as an Employer Does Not Deprive the Contracting Union of Employer Status Within the Meaning of Section 302(c)(5) Vis-A-Vis Its Own Employees.

One final theory for debarring union employees and officers needs to be considered, this one expressed by the District Court for the Southern District of New York. *United States Trucking Corp.* v. *Strong*, 239 F. Supp. 937, pending on appeal before the Court of Appeals for the Second Circuit, No. 29,656. As the basis for denying employer status to the contracting union, and of therefore debarring its employees from participating as beneficiaries of a jointly administered trust fund, the District Court in that case improvised a reason wholly unrelated to the words, purpose, or history of section 302(c)(5). The District Court was concerned that, in considering as an employer the benefits it desired to extend to its employees, the contracting union would have to take into account its "financial ability" to contribute to the trust fund at the same rate as the trucking company employers, the effect of the size of the contributions it would be required to make on the dues and assessments its members would have to pay to defray the cost, and "the effect the employees' rates of contribution will have on its own officers and employees and on the Union's salary and wage scale" (*Id.* at 940). The District Court therefore thought it "obvious" that, by reason of the union's position as an employer of its own employees, there was a "possibility of a conflict of interest" arising detracting from its duty of disinterested service as a representative of the trucking company employees, "and perhaps common interests arising between the Union and the trucking companies . . ." (*ibid.*). On this basis the District Court concluded that

the union could not be an employer vis-a-vis its own employees for the purpose of section 302(c)(5) (*ibid.*).

The Court of Appeals for the Eighth Circuit in *Blassie* v. *Kroger Co.*, 59 LRRM 2034, 2044-45, rejected in terms the reasoning of the District Court, observing that:

> We are aware that, in *United States Trucking Corp.* v. *Strong*, . . . [239 F. Supp. 937] (S.D. N.Y. 1965), the court held that payments by employers to a pension fund, to which the union was a contributor on behalf of its own employees, were not within the exception of § 302(c)(5). As we read that opinion the court arrived at its conclusion because it felt that the union had placed itself in a position of possible conflict of interest. We are not similarly persuaded by that remote possibility. In our view, the issue is whether the exception language of the statute has been met and satisfied and is not whether the union conceivably has placed itself in a position of conflict of interest. The latter does not fall into that category of mischiefs which the legislative history reveals to be the target of the statute.

The possibility of a conflict of interest which the District Court had conjured is entirely abstract. It is a conclusion wholly uninformed by any actual information or realistic appraisal of the amount of the contribution to the trust fund for its employees required of the union as an employer, the financial resources of the union, or the proportion to the union's total expenditures that its contribution to the fund represents. There is therefore a total lack of any factual foundation for genuinely evaluating whether the contribution has a magnitude which can even begin to affect the union's "financial ability" to pay, the amount of union dues and fees, or the level of wages for union employees and officers. Judging as abstractly as the District Court, the great likelihood is that the union's contribution *qua* employer is too minute to have the least influence upon its bargaining position *qua* employee representative.

Moreover, debarring the union from participation as an employer in the trust fund cannot in any event eliminate what minimal influence the size of its contribution could possibly exert on its bargaining stance. The District Court grants that the union can participate in any jointly administered trust fund except one in which the union is the bargaining representative of the employees of the other employers (239 F. Supp. at 941). Yet comparison of fringe benefits granted by different employers is an important factor at the bargaining table in support of a demand, so that, on the District Court's premise, there is a "possibility" that the union's demands as an employee representative would in any event be tempered by realization that it will be confronted with a request by its employees that it match as an employer any gain it succeeds in negotiating as an employee representative. To eliminate any possibility of a conflict of interest the union should therefore be required to eliminate any paid staff. The District Court stops short of this absurdity but the logic of its position does not.

The farfetched nature of the District Court's concern is further apparent from the fact that, while the participation of union officers and employees as beneficiaries of jointly administered funds is widespread (*supra,* pp. 5-6), union demands of employers in negotiations for an increase in contributions and benefits continues to be as vigorous as ever. And, to whatever extent the District Court's apprehension is not dismissible as altogether artificial, the peripheral mischief it perceives is altogether outside the central evil of "bribery", "extortion", and the use of funds "to perpetuate control of union officers, for political purposes, or even for personal gain" at which section 302 is aimed. *Arroyo* v. *United States,* 359 U.S. 419, 426-427.

Furthermore, the District Court's conception that a union's discharge of its duty of fair representation re-

quires elimination of any possibility of conflicting interests is altogether too aseptic for the workaday world. A union's constituency is composed of employee groups with competing interests and inherent in its role as an employee representative is the inescapable necessity of reconciling divergent pulls. Younger employees want across-the-board wage increases, while older employees put greater stock in pensions; any seniority system unavoidably prefers one group and disadvantages another; every allocation of work to one job classification or department disfavors another. "Conflict between employees represented by the same union is a recurring fact." *Humphrey* v. *Moore,* 375 U.S. 335, 349-350. "Inevitably differences arise in the manner and degree to which the terms of any negotiated agreement affect individual employees and classes of employees. The mere existence of such differences does not make them invalid. The complete satisfaction of all who are represented is hardly to be expected. A wide range of reasonableness must be allowed a statutory bargaining representative in serving the unit it represents, subject always to complete good faith and honesty of purpose in the exercise of its discretion." *Ford Motor Co.* v. *Huffman,* 345 U.S. 330, 338. In the face of the reality of conflicting interests among employees, and the responsibility entrusted to the union to resolve the differences in good faith, it is patent that the District Court's conception that "a possible conflict of interest" is of itself inconsistent with fair representation is too rarefied to be acceptable. In view of the compatibility with fair representation of far weightier conflicts, the minimal influence that can possibly be exerted by the union's contribution to the fund as an employer does not begin to count as a disqualifying factor.

Also wide of the mark is the District Court's invocation of the metaphor that an employer cannot "sit on both sides of the bargaining table" (239 F. Supp. at 940). That

quotation pertains to a union dominated or assisted by an employer through unfair labor practices. *American Enka Corp.* v. *N.L.R.B.*, 119 F. 2d 60, 62-63 (C.A. 4). Within the unfair labor practice area itself, in determining whether domination or assistance exists, total war between the employer and union is not the indispensable sign of an undominated and unassisted labor organization; "mutual forbearance and compromise need not impugn the independence of a union" *Western Union Tel. Co.* v. *N.L.R.B.*, 113 F. 2d 992, 997 (C.A. 2). Furthermore, when dealing with a union neither dominated nor assisted by employer unfair labor practices, analogy to a dominated or assisted union is quite unpersuasive even within the unfair labor practice area. *Local 60, Carpenters* v. *N.L.R.B.*, 365 U.S. 651, 653-654. Outside that area, as is the situation in this case, the analogy is not even colorably germane.

In short, the District Court relies upon "a possible conflict of interest" which is entirely abstract, upon a concept of the inconsistency of conflicting interests with faithful discharge of the duty of fair representation which is entirely unrealistic, and upon an analogy to an employer-assisted or dominated union which is entirely inapposite. And, in drawing upon this "circumambient aura,"[111] the District Court strays from the statutory text, its particularized history, and the specific mischief at which it is aimed. The infirmity of its premises invalidates its decision.

CONCLUSION

For the reasons stated, section 302 of the Labor Management Relations Act, 1947, does not bar retired employees and officers and employees of the contracting union from participating as beneficiaries of a jointly administered trust fund, whether a welfare fund as in the case

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[111] Judge Learned Hand concurring in *McComb* v. *Scerbo*, 177 F.2d 137, 141 (C.A. 2).

of retired employees, or a welfare fund and pension fund as in the case of union officers and employees.

Respectfully submitted,

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June 1965.

Certificate of Compliance

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with these rules.

BERNARD DUNAU
Attorney for Amicus Curiae

APPENDIX

U.S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
WASHINGTON 25, D. C.

[SEAL]

In reply refer to
T:R:EO:5
RMB

June 27, 1963

Steamfitters Local No. 601 Health and Welfare Fund
c/o Roy E. Cassel et al., Trustees
4112 West Burleigh Street
Milwaukee 10, Wisconsin

Gentlemen:

This is in reply to your letter of June 20, 1963, referring to a letter of January 30, 1963, requesting a clarification regarding the effect the extending of benefits to retirees may have upon the business deductions of contributing employers and on your tax exempt status.

It is stated that existing retirees, who were at one time active employees in the jurisdiction of Steamfitters' Local No. 601, presently receive life insurance and you are considering extending surgical-medical benefits to those presently retired, as well as those who will retire.

It is our conclusion that your present tax-exempt status will not be jeopardized by extending surgical-medical benefits to both employees who are presently retired and those employees who retire in the future. The exempt status of a voluntary employees' beneficiary association in no way depends upon whether coverage of specific individuals is attributable to specific contributions by, or on behalf of, such individuals. Thus a welfare fund could make payments for such benefits from existing reserves, employer

contributions or contributions made by the retired employees.

Concerning the question as to the deductibility of the employer contributions, under the stated circumstances, Section 6 of Revenue Procedure 62-28, C.B. 1962-2, at page 501, provides in part that a request for a ruling must be signed by the taxpayer (in this case an employer making contributions to your Fund) or, if such request is made by a representative of the taxpayer, the conference and practice requirements regarding the furnishing of a proper power of attorney, evidence of enrollment to practice, etc., must be met.

Since you are neither the taxpayer nor the recognized representative of a contributing employer, it is not feasible to issue the ruling requested. However, the following general information is furnished with respect to the employer contributions, is being understood that the contents thereof do not constitute a ruling on a specific matter.

In the instance where a determination is made that an expense of the kind involved herein relates to the regular conduct of the employer's business for promoting the general well-being and welfare of the employees, the consideration for which is intended to produce benefits flowing directly to the employer's business, the amounts paid by the employer would constitute ordinary and necessary expenses directly connected with the operation of the business, which would be deductible under the provisions of section 162(a) of the Internal Revenue Code of 1954.

Very truly yours,

/s/ John W. S. Littleton
Director, Tax Ruling Division

No. 20,068

IN THE

United States Court of Appeals

For the Ninth Circuit

JIM GARVISON, et al.,
Appellants,

vs.

NORMAN A. JENSEN,
Appellee.

BRIEF OF CARPENTER FUNDS ADMINISTRATIVE OFFICE OF NORTHERN CALIFORNIA, INC., LABORERS HEALTH AND WELFARE TRUST FUND FOR NORTHERN CALIFORNIA, LABORERS PENSION TRUST FUND FOR NORTHERN CALIFORNIA, CEMENT MASONS HEALTH AND WELFARE TRUST FUND FOR NORTHERN CALIFORNIA, CEMENT MASONS PENSION TRUST FUND FOR NORTHERN CALIFORNIA, CARPENTERS HEALTH AND WELFARE TRUST FOR SOUTHERN CALIFORNIA, CARPENTERS PENSION TRUST FOR SOUTHERN CALIFORNIA AND PACIFIC COAST SHIPYARDS METAL TRADES TRUST FUND, AS AMICI CURIAE IN SUPPORT OF APPELLANTS

CHARLES P. SCULLY,
995 Market Street,
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No. 20,068

IN THE

United States Court of Appeals

For the Ninth Circuit

JIM GARVISON, et al.,
Appellants,

vs.

NORMAN A. JENSEN,
Appellee.

BRIEF OF CARPENTER FUNDS ADMINISTRATIVE OFFICE OF NORTHERN CALIFORNIA, INC., LABORERS HEALTH AND WELFARE TRUST FUND FOR NORTHERN CALIFORNIA, LABORERS PENSION TRUST FUND FOR NORTHERN CALIFORNIA, CEMENT MASONS HEALTH AND WELFARE TRUST FUND FOR NORTHERN CALIFORNIA, CEMENT MASONS PENSION TRUST FUND FOR NORTHERN CALIFORNIA, CARPENTERS HEALTH AND WELFARE TRUST FOR SOUTHERN CALIFORNIA, CARPENTERS PENSION TRUST FOR SOUTHERN CALIFORNIA AND PACIFIC COAST SHIPYARDS METAL TRADES TRUST FUND, AS AMICI CURIAE IN SUPPORT OF APPELLANTS

INTRODUCTORY STATEMENT

By motion duly made and presented to this Court the undersigned herewith asks permission to file a brief as amicus curiae in the above-entitled matter. The undersigned is co-counsel with the Law Offices of

Johnson & Stanton of San Francisco for the Carpenter Funds Administrative Office of Northern California, Inc., for the Laborers Health and Welfare Trust Fund for Northern California, for the Laborers Pension Trust Fund for Northern California, for the Cement Masons Health and Welfare Trust Fund for Northern California, and for the Cement Masons Pension Trust Fund for Northern California; the undersigned is in addition co-counsel with Dillavou and Cox of Los Angeles for the Carpenters Health and Welfare Trust for Southern California and the Carpenters Pension Trust for Southern California; the undersigned is also co-counsel with Bogle, Bogle and Gates of Seattle for the Pacific Coast Shipyards Metal Trades Trust Fund.

The undersigned was granted leave by the United States Court of Appeals for the Eighth Circuit on August 18, 1964 to file an amicus curiae brief in *Blassie v. Kroger Co.*, ...F. 2d ....., 59 LRRM 2034. Thereafter the undersigned filed its brief amicus curiae in much the same form as is presented here and was gratified to find each one of its points sustained by the Court. It would be the undersigned's desire to aid this Court in the same manner.

It is desired, of course, to approve and incorporate everything which appellants have argued; but in light of the fact that this case raises questions of first impression for this Circuit Court of Appeals and has been only recently considered in one other circuit, it is desired to make additional argument to this Court and to inform it in some further detail.

1. IN RELATED FIELDS OF INTEREST, CALIFORNIA STATE LAW HAS NEVER FOUND ANY REASON TO LIMIT THE DEFINITION OF "EMPLOYEE" AS DID THE LOWER COURT.

The brief of Appellant argues to the Court that the broader view of the word "employee" is actually much more in harmony with the rightful and desirable ends Congress sought.[1] The narrow view of the lower Court is not only without foundation but, on the contrary, the broader view guarantees employee welfare and security much more fully. It is here proposed to call the Court's attention briefly to the fact that in those laws of the State of California which pertain to the same general area of interest, there has never been found any need to serve the ends of the respective statutes by recourse to such a narrow definition of "employee."

On the contrary, there is California law in the State Insurance Code which not only expressly includes the retired employee but also the trustees and their employes. Thus reads in part Section 10202.8 of the Insurance Code:

> "§10202.8. A group life policy conforming to all of the following conditions may be issued to the trustees of a fund established by one employer, or by two or more employers in the same industry, or by an association of employers in the same industry, or by one or more labor unions, or by one or more employers and one or more labor unions or by an association of employers and one or more labor unions, to insure employees of the employers or members of the unions for the bene-

[1]Brief of Appellants, pp. 19-20.

fit of persons other than the employers or the unions:

"(a) The persons eligible for insurance shall be all of the employees of the employers or all of the members of the unions, or all of any class or classes thereof determined by conditions pertaining to their employment, or to membership in the unions, or to both. The policy may provide that the term 'employees' shall include retired employees, and the individual proprietor or partners if any employer is an individual proprietor or a partnership. No director of a corporate employer shall be eligible for insurance under the policy unless such person is otherwise eligible as a bona fide employee of the corporation by performing services other than the usual duties of a director. No individual proprietor or partner shall be eligible for insurance under the policy unless he is actively engaged in and devotes a substantial part of his time to the conduct of the business of the proprietor or partnership. The policy may provide that the term 'employees' shall include the trustees or their employees, or both, if their duties are principally connected with such trusteeship."

The California Retirement Systems Law was added by 1949 legislation as a codification of the 1945 Retirement Systems Act. The definition of "employees" used therein is without apparent limitation just as the term appears in Sec. 302(c)(5):[2]

---

[2]California Corporations Code, Division 3, §§28000, 28501, California Statutes 1949, c. 462, p. 805, §1 added as a codification to California Statutes 1945, c. 1035, p. 1996.

> "§28002. As used in this division, 'employees' means the employees of any employer."[3]

With such a definition presumably in mind, the California Legislature then went on to delineate the benefits available to retirees:[4]

> "§28402. A retirement system may provide benefits on account of members retiring by reason of age or length of service or both, or on account of death, and may include benefits for sickness or accident disability, or medical and hospitalization expenses in connection with sickness or accident disability, or benefits in the form of equities which may include the right to receive a portion of the trust fund on severance of employment and the right to receive a percentage of the trust fund after the lapse of a period of service or of participation, or any or all of such benefits, and may include a stock bonus or profit sharing plan."

It is a fair presumption that the State of California was as concerned with possible abuse and diversion as was the Congress in the federal tax and labor laws. Indeed, a perusal of the related sections to the above-cited California law makes this evident. Nowhere, however, is there the slightest inkling of an intent to limit the definition of "employee." Nowhere is it deemed necessary to do so in order to attain the legislative ends desired and to secure against abuse. As with the Congress, so too the intent of the California Legislature is just the opposite; it wishes to extend a full schedule of benefits to retired employees.

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[3]id. §28002.

[4]id. §28402.

2. THE NARROW DEFINITION OF AN "EMPLOYEE" WITHIN THE UNDERSTANDING OF THE LOWER COURT'S DECISION IS TO BE CONTRASTED TO THE ECONOMIC REALITY OF PENSION AND HEALTH AND WELFARE FUNDS OF WHICH PRESUMABLY CONGRESS HAS ALWAYS BEEN AWARE.

Sections 23(a) and 23(p), 165, 101(16) of the old Internal Revenue Code are ample evidence that pension and health and welfare plans were already on the scene well before the advent of the 1947 labor legislation. And the incidence of such arrangements has mushroomed greatly. President's Committee on Corporate Pension Funds and other Private Retirement and Welfare Program, "Public Policy and Private Pension Programs", 3 CCH Labor Law Rptr. para. 8095.

As an aid to the Court in understanding the size and importance of such funds, it is proposed to delineate briefly the operations of the second largest plan west of Chicago. By so doing, it is hoped that renewed emphasis will be given to an appreciation of the size and economic and social importance of these plans; and, it is hoped that it will thereby become clearer that with knowledge of such common practice and importance Congress not only did not legislate in the way claimed by the lower Court but obviously has never seen fit to do so.

The Carpenter Funds Administration Office of Northern California, Inc., is the administrator of some five funds: Carpenters Health & Welfare Trust Fund for California, Carpenters Pension Trust Fund for Northern California, Four Bay Counties Carpen-

ters Vacation Trust Fund, Forty-Two Northern California Counties Carpenters Vacation Trust Fund, and Carpenters Apprenticeship and Training Trust Fund for Northern California.

On such funds as health and welfare and pension over 40,000 reports of hours worked by carpenters are received at the Fund's office each month from approximately 7,000 employers. Excluding dependents, some 34,000 carpenters are presently eligible for health and welfare benefits and eventually for pension benefits. The number of retirees alone is presently 2,187. Two hundred twenty-five thousand dollars ($225,000.00) is being expended each month in payment of pension benefits.

The schedule of benefits is varied and comprhensive. The Pension Plan, entered into in 1958, provides for minimum payments of $65.00 per month up to a maximum of $125.00 a month to eligible retired carpenters, and some 175 officials of the unions. The Health and Welfare Fund, entered into in 1953, provides a surgical, X-ray, diagnostic, and hospital schedule for all eligibles, their dependents, officials of the unions and the administrative personnel of the Fund's office. Both of the Vacation Funds, entered into in 1957 and 1961, respectfully, pay out on a revolving basis, that is, they pay out whatever is received in a given year to eligible carpenters during the succeeding vacation periods. The Apprenticeship Fund represents a complex effort to meet the problems of unemployment and automation at the other end of the age spectrum.

In order to afford the Court some idea of the economic strength which secures these benefits, it can be noted that over 36 million dollars in "rolling" money comes in each year from contractors by way of contributions. The overall figure currently busy in investment is in excess of 55 million dollars.

It is self-evident that large funds such as these present much sturdier and efficacious means of investment and guaranteed return than a small group of union employees or fund administrative personnel could ever secure on a smaller autonomous level of operations. The ability to merge administration, investment, and actuarial experiences inevitably results in a much higher level of benefits to the employee, whether an employee of the contractor, the union or the fund.

It is to be noted that the same employers and employees are involved in these funds; and, therefore, the retirees, for example, are also benefiting from the Health and Welfare Fund.

It is also to be noted that as to officials of the union the contributions for them are made by their respective employer, viz, the union. Thus there is no confusion of the source of these contributions; there are three distinct entities, distinct not only legally but in their respective operations. The Fund is neither "the Union" nor "the contractor."

From the aforementioned complexity and commitment in which both employer and employees find themselves it becomes apparent that a narrow inter-

pretation of the word "employee" is totally out of joint with what has been the socio-economic reality for years. Thus it is that there has been an obvious commitment to a definition of the employer-employee relationship which has increasingly little relation to the time spent in actual work; or, to approach the matter from another direction, the forms of compensation have become myriad and attentive to the problems of old age and security. Despite the importance and size of funds such as the ones outlined above Congress has never deemed it necessary to draw a distinction such as drawn by the lower Court. On the contrary, it may be fairly noticed that the intent of Congress has been to applaud and support such far-reaching plans.

CONCLUSION

It is respectfully submitted that the decision of the lower Court be reversed.

Dated, San Francisco, California,
June 16, 1965.

Respectfully submitted,
CHARLES P. SCULLY,
JOHNSON & STANTON,
DILLAVOU & COX,
BOGLE, BOGLE & GATES,
By CHARLES P. SCULLY,
Attorneys for Amici Curiae.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

CHARLES P. SCULLY,
Attorney.

CERTIFICATE OF SERVICE BY MAIL

(C.C.P. §1013A and 2015.5)

I, Aileen F. Quinn, declare that I am a citizen of the United States, over 18 years of age, a resident of San Francisco County, and not a party to the within action.

That my business address is 995 Market Street, San Francisco, California.

That a copy of the attached BRIEF OF CARPENTER FUNDS ADMINISTRATIVE OFFICE OF NORTHERN CALIFORNIA, INC., LABORERS HEALTH & WELFARE TRUST FUND FOR NORTHERN CALIFORNIA, LABORERS PENSION TRUST FUND FOR NORTHERN CALIFORNIA, CEMENT MASONS HEALTH & WELFARE TRUST FUND FOR NORTHERN CALIFORNIA, ET AL

was served by me by placing said copy in an envelope addressed to:

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I certify under penalty of perjury that the foregoing is true and correct.

Executed on June 30, 1965.

/s/ Aileen F. Quinn

No. 20068

In the

United States Court of Appeals

For the Ninth Circuit

JIM GARVISON, G. E. CHINN, W. DON CAWOOD, CECIL SEAVEY, W. T. BOYD, H. C. RADATZ, CLIFFORD E. HINES and ROBERT E. DAVIS, TRUSTEES OF OREGON AND SOUTHWEST WASHINGTON PAINTERS PENSION TRUST FUND; E. W. SHIELDS, FRED PETERSON, EARL DILTS, JACK ROPER, W. T. BOYD, H. C. RADATZ, CLIFFORD E. HINES and ROBERT E. DAVIS, TRUSTEES OF OREGON AND SOUTHWEST WASHINGTON PAINTERS MEDICAL-HOSPITALIZATION TRUST FUND; PORTLAND AREA PAINTERS AND DECORATORS JOINT COMMITTEE, INC., a non-profit Oregon corporation; and LOCAL NO. 10 OF THE BROTHERHOOD OF PAINTERS, DECORATORS & PAPERHANGERS OF AMERICA, *Appellants,*

vs.

NORMAN A. JENSEN, *Appellee.*

APPELLANTS' BRIEF

Appeal from the United States District Court for the District of Oregon
HONORABLE JOHN F. KILKENNY, *Judge*

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No. 20068

In the

United States Court of Appeals

For the Ninth Circuit

JIM GARVISON, G. E. CHINN, W. DON CAWOOD, CECIL SEAVEY, W. T. BOYD, H. C. RADATZ, CLIFFORD E. HINES and ROBERT E. DAVIS, TRUSTEES OF OREGON AND SOUTHWEST WASHINGTON PAINTERS PENSION TRUST FUND; E. W. SHIELDS, FRED PETERSON, EARL DILTS, JACK ROPER, W. T. BOYD, H. C. RADATZ, CLIFFORD E. HINES and ROBERT E. DAVIS, TRUSTEES OF OREGON AND SOUTHWEST WASHINGTON PAINTERS MEDICAL-HOSPITALIZATION TRUST FUND; PORTLAND AREA PAINTERS AND DECORATORS JOINT COMMITTEE, INC., a non-profit Oregon corporation; and LOCAL NO. 10 OF THE BROTHERHOOD OF PAINTERS, DECORATORS & PAPERHANGERS OF AMERICA,

Appellants,

vs.

NORMAN A. JENSEN,

Appellee.

APPELLANTS' BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY, *Judge*

JURISDICTIONAL STATEMENT

This is a civil suit brought by the appellee to enjoin the appellants from enforcing the provisions of a collective bargaining agreement (Plaintiff's Ex. 1) and from collecting contributions due to a Pension Trust and a Medical Trust under the provisions of said agreement. The "Agreed Facts" in the pretrial order show

that the appellee is an employer, party to said agreement, and that said contract was between employers engaged in an industry affecting commerce and unions representing employees in an industry affecting commerce (R. 62, l. 10-11, l. 16-18; R. 63, l. 15-19). The pretrial order also shows that certain of the appellants are trustees, administering the Pension Trust Fund, and that, of these trustees, four represent employers and four represent employees (R. 62, l. 22-25). The Medical-Hospitalization Trust, hereinafter referred to as "Medical Trust" is also administered by a board of trustees, four of whom represent employers, and the remaining four represent employees (Plaintiff's Ex. 4). The appellant trustees of each trust counterclaimed for the amounts due from appellee to the respective trusts.

The jurisdiction of the District Court was based upon the provisions of Sections 301 and 302 (e) of the Labor Management Relations Act of 1947, 29 USCA §185 and §186 (e) and this Court has jurisdiction to review the judgment by virtue of 28 USCA §1291. Judgment was entered by the District Court on February 2, 1965 (R. 85); notice of appeal was filed on March 3, 1965, accompanied by an appropriate bond (R. 97 and R. 99).

STATEMENT OF THE CASE

This case involves two typical trusts, created as a result of collective bargaining negotiations between em-

ployers and labor organizations representing their employees. The first is a Medical Trust, which has existed since 1953 (Plaintiff's Ex. 4, p. 2), and the second is a Pension Trust, which is more recent and which was created as a result of the 1962-63-64 collective bargaining agreement (Plaintiff's Ex. 1). The appellee is a painting contractor and is a party to said contract. Both trusts have been approved by the Internal Revenue Service (Defendant's Ex. 5 and 6). The Medical Trust Agreement (Plaintiff's Ex. 4) and the Pension Trust Agreement (Plaintiff's Ex. 2) permit the unions to cover their officers and other employees by making payments to the Trusts. The appellee contended, and the District Court found, that the aforementioned provisions of each Trust Agreement were illegal under the provisions of Section 302 (c) (5) of the Labor Management Relations Act of 1947, and that the practices followed by the trustees and the Unions in extending coverage to officers and other employees of the Unions were all illegal under this statute.

Commencing in 1958, the trustees of the Medical Trust extended certain benefits to retired painters who met certain minimum eligibility requirements, set forth hereinafter. The appellee contended, and the District Court found, that the extension of benefits to such retirees was not permissible under Section 302 (c) (5) of the Labor Management Relations Act of 1947. Conse-

quently, this case presents the following questions for determination by this Court:

(a) Whether it is permissible, under the provisions of Section 302 of the Labor Management Relations Act of 1947, 29 USCA §186, for a labor union to provide coverage for its employees, including its officers, by making payments to a jointly administered medical trust and to a pension trust.

(b) Whether it is permissible, under the provisions of Section 302 of the Labor Management Relations Act of 1947, 29 USCA §186, for a jointly administered medical trust to provide, through insurance, medical and hospital benefits for retired employees who were beneficiaries of the Plan prior to their retirement and upon whose work employer parties to the collective bargaining agreement had made payments to the Trust.

The appellee made payments to the two Trusts until April, 1963 (Tr. 123, l. 13-15). The appellant trustees of each Trust counterclaimed for the amounts owed from the appellee to each Trust for the period from May 1, 1963, through August 31, 1964. The amounts of such contributions owed for that period are not in dispute (R. 63, l. 20-31).

The case also involves the appellee's liability for liquidated damages to each of the Trusts, in accordance with the terms of the respective trust agreements (Plaintiff's Ex. 2, pp. 11 and 12, and Plaintiff's Ex. 12, pp. 10 and 11), which agreements are incorporated by reference in the collective bargaining agreement (Plaintiff's Ex. 1).

STATUTE INVOLVED

Section 302 of the Labor Management Relations Act of 1947, 29 USCA §186, in relevant part, provides:

> "(a) It shall be unlawful for any employer or association of employers or any person who acts as a labor relations expert, adviser, or consultant to an employer or who acts in the interest of an employer to pay, lend, or deliver, or agree to pay, lend, or deliver, any money or other thing of value —
>
> (1) to any representative of any of his employees who are employed in an industry affecting commerce; or
>
> (2) to any labor organization, or any officer or employee thereof, which represents, seeks to represent, or would admit to membership, any of the employees of such employer who are employed in an industry affecting commerce; or
>
> (3) to any employee or group or committee of employees of such employer employed in an industry affecting commerce in excess of their normal compensation for the purpose of causing such employee or group or committee directly or indirectly to influence any other employees in the exercise of the right to organize and bargain collectively through representatives of their own choosing; or

(4) to any officer or employee of a labor organization engaged in an industry affecting commerce with intent to influence him in respect to any of his actions, decisions, or duties as a representative of employees or as such officer or employee of such labor organization.

(b) (1) It shall be unlawful for any person to request, demand, receive, or accept, or agree to receive or accept, any payment, loan, or delivery of any money or other thing of value prohibited by subsection (a) of this section.

* * *

(c) The provisions of this section shall not be applicable * * *

(5) with respect to money or other thing of value paid to a trust fund established by such representative, for the sole and exclusive benefit of the employees of such employer, and their families and dependents (or of such employees, families, and dependents jointly with the employees of other employers making similar payments, and their families and dependents): *Provided*, That

(A) such payments are held in trust for the purpose of paying, either from principal or income or both, for the benefit of employees, their families and dependents, for medical or hospital care, pensions on retirement or death of employees, compensation for injuries or illness resulting from occupational activity or insurance to provide any of the foregoing, or unemployment benefits or life insurance, disability and sickness insurance, or accident insurance;

(B) the detailed basis on which such payments are to be made is specified in a written agreement with the employer, and employ-

ees and employers are equally represented in the administration of such fund, together with such neutral persons as the representatives of the employers and the representatives of employees may agree upon and in the event the employer and employee groups deadlock on the administration of such fund and there are no neutral persons empowered to break such deadlock, such agreement provides that the two groups shall agree on an impartial umpire to decide such dispute, or in event of their failure to agree within a reasonable length of time, an impartial umpire to decide such dispute shall, on petition of either group, be appointed by the district court of the United States for the district where the trust fund has its principal office, and shall also contain provisions for an annual audit of the trust fund, a statement of the results of which shall be available for inspection by interested persons at the principal office of the trust fund and at such other places as may be designated in such written agreement; and

(C) such payments as are intended to be used for the purpose of providing pensions or annuities for employees are made to a separate trust which provides that the funds held therein cannot be used for any purpose other than paying such pensions or annuities; or

(6) with respect to money or other thing of value paid by any employer to a trust fund established by such representative for the purpose of pooled vacation, holiday, severance or similar benefits, or defraying costs of apprenticeship or other training programs: *Provided*, That the requirements of clause (B) of the proviso to clause (5) of this subsection shall apply to such trust funds."

SPECIFICATIONS OF ERROR

1. The District Court erred in finding that the pro visions of the Pension Trust Agreement providing fo participation therein by Union officers and employee designated by the Unions and their actual participatio therein, and payment by the Unions to said Pensio Trust on their behalf, and receipt thereof by said Pen sion Trust were illegal and in violation of Section 30 of the Labor Management Relations Act, 29 USCA §186

2. The District Court erred in finding that the pro visions of the Medical Trust Agreement providing fo contributions by the Unions on behalf of officers an employees designated by the Unions, and the paymen by said Unions and receipt thereof by the Medical Trus were illegal and in violation of Section 302 of the Labo Management Relations Act, 29 USCA §186.

3. The District Court erred in finding that the prac tice of the Trustees of the Medical Trust in providin coverage for retired journeymen and their dependent was illegal and in violation of Section 302 of the Labo Management Relations Act, 29 USCA §186;

4. The District Court erred in finding that the ben fits provided for such retired employees and their wive were provided for by "extra assessments" now bein paid by employers.

5. The District Court erred in finding that the Appellee would be guilty of a criminal offense in making payments to the Pension Trust and to the Medical Trust.

6. The District Court erred in enjoining the trustees of the Pension Trust from demanding, collecting, receiving or attempting to collect or receive from Appellee any money or contributions, and in failing to enter judgment for said trustees of the Pension Trust in accordance with their counterclaim.

7. The District Court erred in enjoining the trustees of the Medical Trust from demanding, collecting, receiving or attempting to collect or receive from Appellee any money or contributions, and in failing to enter judgment in favor of said trustees of the Medical Trust in accordance with their counterclaim.

8. The District Court ererd in denying Appellants' motion to amend the judgment.

SUMMARY OF ARGUMENT

Section 302 of the Labor Management Relations Act of 1947, 29 USCA §186 does not prohibit unions from providing coverage for their officers and other employees under medical-hospitalization trusts or pension trusts that are jointly administered by employer trustees and employee trustees in compliance with the statute. Unions may be treated as employers for the purpose of

making appropriate payments to such trusts to provide such coverage, but the unions have no voice in the selection of employer trustees.

Health and welfare benefits may lawfully be provided by trustees of a jointly administered welfare trust to retired employees if such retired employees were covered under the trust prior to their retirement. The word "employees," within the meaning of Section 302, necessarily includes former employees of contributing employers, as well as presently active employees.

ARGUMENT

I.

THE DISTRICT COURT ERRED IN FINDING THAT THE PROVISIONS OF THE TRUST AGREEMENTS AUTHORIZING COVERAGE OF UNION EMPLOYEES WERE ILLEGAL, AND IN FINDING THAT THE PRACTICES OF THE TRUSTEES AND THE UNIONS IN THIS RESPECT WERE PROHIBITED BY SECTION 302 (c) (5) OF THE LABOR MANAGEMENT RELATIONS ACT OF 1947.

(a) Preliminary Statement and Background.

The leading precedents on this and the retired employee question now are the decisions of the Court of Appeals for the Eighth Circuit in *Blassie v. Kroger Co.*, ___ F2d ___, 59 LRRM 2034, and *Local 688, International Brotherhood of Teamsters v. Townsend*, ___ F2d

—, 59 LRRM 2048. These cases had not been decided, of course, at the time the District Judge rendered his opinion in the instant case. As a matter of fact, Judge Kilkenny relied in part upon the opinions of District Judge Harper in the *Blassie* and *Townsend* cases in arriving at the conclusion that coverage of union employees was improper under the statute. (See Opinion, R. 80, 1. 2-6.) The Court of Appeals for the Eighth Circuit reversed the District Court on both counts, holding that coverage of union officers and employees by a jointly administered trust did not violate the statute, and also holding that it was permissible to extend health and welfare benefits to retired employees who had been covered by the plan prior to their retirement. *Blassie v. Kroger*, supra, and *Local 688, International Brotherhood of Teamsters v. Townsend*, supra.

While the foregoing decisions are the leading authorities in this field, it is also interesting to note that in *Sanders v. Birthright*, 172 F Supp 895, 899, a welfare trust agreement provided that "Individuals eligible for group insurance are * * * (d) Employees of the Union, not herein otherwise specified." The District Court in that case noted that the trust agreement "* * * in all ways complied with the statutory requirements set out in Section 302 (c) (5) * * *."

In the instant case, the Pension Trust Agreement

(Plaintiff's Ex. 2, at p. 2) includes the following provision:

> "It is understood that the Union party to this agreement may be considered an employer hereunder if permitted by law or governmental regulations to be so considered with respect to employees directly employed by such Union in its own affairs; provided, however, that the Union shall be considered as an employer hereunder in such event for the sole purpose of being able to include its employees as beneficiaries of this Pension Plan and shall not be considered as an employer for purposes of the obligations and rights reserved to employers otherwise defined herein and, provided, further, that only union employees who occupy positions in which they directly participate in the furtherance of the business of the Union may be so included as distinguished from clerical or stenographic employees."

The testimony of Mr. Eggimann established that the Unions are paying to the Pension Trust on the same basis as painting contractors — i.e., at the rate of ten cents per hour worked by the union employees (Tr. 132, l. 21, to Tr. 133, l. 2), and that union employees are treated the same as employees of contractors under the Pension Plan (Tr. 131, l. 6-15).

The Medical Trust Agreement (Plaintiff's Ex. 4, at p. 2) contains language practically identical to that above quoted from the Pension Trust Agreement with respect to the Unions' being treated as employers for the limited purpose of covering their employees. The

Medical Trust also provides, on page 2, for "Associate Employees", defining such employees as "employees of the Union and employees who are outside the bargaining unit represented by the Union and whom the Union or employer elects to cover on a uniform non-selective basis, as determined by the Trustees." Further the Medical Trust Agreement (Plaintiff's Ex. 4, at pp. 6 and 7) provides that the trustees shall have the power and duty to

> "(j) Establish and fix a monthly amount to be contributed to the fund for and on behalf of 'associate employees'. Such amount shall be commensurate with the insurance premium charged to provide insurance coverage for employees within the bargaining unit. The Union, however, may elect to make payments on an hourly basis in the same amounts as provided by the collective bargaining agreement for those employees who occupy positions in which they directly participate in the furtherance of the business of the Union, as distinguished from clerical or stenographic employees."

It is apparent that the Medical Trust permits the employers to cover employees other than painters by paying the monthly amount fixed by the trustees to the Trust. This, of course, is a common practice. The reason for the provision permitting the Unions to pay on their employees on an hourly basis rather than the monthly flat fee was explained by Mr. Herrle. As he testified (Tr. 104, l. 7 to Tr. 105, l. 12), when payments are

made on an hourly basis, a "reserve" of up to one thousand hours may be accumulated by the employee upon whom such payment is being made, while, if the flat fee method is used, no reserve is accumulated for the employee.

In summary, the Unions are permitted by the Medical Trust to cover their employees by paying the flat fee commensurate with the cost of insurance or they may pay the same hourly rate as painting contractors. If the flat fee method is used, the union employees do not accumulate any reserve, while if the other method is used, they may accumulate a reserve in the same manner as employees of painting contractors.

We have pointed out the foregoing features of the two Trusts to show that there is no advantage or favoritism given to Union employees over painters working at the trade. The practice of providing coverage for Union officers and employees under Health and Welfare and Pension Plans with the Union making appropriate payments to the Trusts is of course very common. This is understandable for obvious reasons. Union business representatives and financial secretaries come from the rank and file membership of the Union. If they were not serving the Union full-time, they would be working with the tools of the trade, and their employers would be making payments on their hours worked to the re-

spective Trusts. Consequently, as pointed out by Mr. Hill (Tr. 141, l. 21-25), if the Unions are denied the right to make payments to the Trusts while these individuals are working for the Unions, members would be discouraged from seeking such positions in their Unions. Clearly, Congress did not intend this result. It is well known that one of the reasons for the enactment of certain provisions of the Labor Management Reporting and Disclosure Act of 1959 (Landrum-Griffin Law, 29 USCA §§ 411-415) was to encourage democratic processes in union affairs. This objective certainly would not be served by making the Union positions less attractive by denying the individual members the same benefits which they would enjoy if they continued to work at the trade.

We submit that it makes no difference whatsoever whether the Union personnel, provided coverage under the Medical Trust or the Pension Trust, are considered as "officers" or not. See *Blassie v. Kroger*, supra at ___ F2 ___, 59 LRRM 2045. In any event, these persons are performing services for the Union and are paid by the Union for those services.

(b) The Union as an Employer.

There is no question but that a Union may qualify statutorily as an employer. In *Office Employes Interna-*

tional Union, Local No. 11, v. N.L.R.B., 353 US 313, the United States Supreme Court held that the conclusion that a union could be an employer under the statute was "inescapable" (353 US at 318). However, as pointed out by the court in *Blassie v. Kroger*, supra, at ___ F2d ___, 59 LRRM 2044, this does not mean that the Union has any voice in the selection of employer trustees. In the instant case, this conclusion is supported by the specific language in the respective trust agreements, the effect of which is to limit the rights of the Unions to the making of appropriate payments to the Trusts to provide coverage for their employees.

(c) Coverage of Union Employees Does Not Conflict with Congressional Purpose

There is absolutely no indication that Congress had in mind prohibiting the extension of coverage to Union officers and other Union employees by welfare or pension trusts in the manner that this is accomplished in the instant case. Congress did have certain evils or dangers in mind when enacting this legislation, in 1947. It appears that the immediate reason why Congress devoted its attention to this area was the demand by the United Mine Workers for a welfare fund that would be under the exclusive control of the Union, *United*

States v. Ryan, 350 US 299, 304-305; *Arroyo vs. United States*, 359 US 419, 426. It is clear that Congress feared "the possible abuse by union officers of the power which they might achieve if welfare funds were left to their sole control;" it was also concerned that "such funds might be employed to perpetuate control of union officers, for political purposes, or even for personal gain." *Arroyo v. United States*, supra, at 359 US 426. It is equally clear that Congress felt that these potential evils or abuses would be prevented by the provisions it did adopt, requiring that trust agreements specify the benefits to be paid and that there be joint administration of these trusts by employer trustees and employee trustees, with appropriate provisions to break deadlocks.

Certainly, permitting Union employees, including officers of the Union, to participate in health and welfare trusts and pension trusts on a basis no more favorable than that accorded to other employees in the bargaining unit does not constitute any part of an evil or abuse which Congress was seeking to overcome. On the contrary, we submit that to deny such Union employees the right so to participate would conflict with the express policy announced by Congress in 1959, as hereinabove suggested.

II.

THE DISTRICT COURT ERRED IN FINDING THAT THE EXTENSION OF CERTAIN BENEFITS TO RETIRED EMPLOYEES BY THE TRUSTEES OF THE MEDICAL TRUST WAS IN VIOLATION OF SECTION 302 OF THE LABOR MANAGEMENT RELATIONS ACT OF 1947.

(a) Preliminary Statement and Background.

The Medical Trust has existed since 1953, and prior collective bargaining agreements have provided for employer payments to this Trust. (See Defendants' Ex. 3, p. 15 — Area Agreement for 1959, 1960 and 1961, and Defendants' Ex. 4, p. 15 — Area Agreement for 1956, 1957 and 1958.) In 1958, the trustees of the Medical Trust obtained certain coverage for retired employees who met established minimum qualifications. These qualifying requirements are set out in the final rider to the 1963 insurance contract (Defendants' Ex. 1) and in the Booklet (Defendants' Ex. 16 at p. 22.) The minimum requirements for retired employees to be entitled to coverage were as follows:

1. He must have been insured under the group policy between the carrier and the Trust immediately preceding his date of retirement;

2. On his retirement, he must

(a) have attained at least 65 years of age;

(b) have completed at least 12 years of service in the industry after attaining the age of 45 years;

(c) have had at least 12 months of coverage as an active employee since January 1, 1955;

(d) be eligible for Social Security benefits;

(e) not be eligible for any benefits under the Fund other than as a retired employee.

Perhaps the most important feature of the foregoing ligibility provisions is that which requires "at least 2 months of coverage as an active employee since anuary 1, 1955;". This requirement, alone, means of ourse that the retired employee would have had sub- tantial payments made to the Trust by his employer or mployers prior to his retirement. Thus, the require- ient set forth by the Court in *Blassie v. Kroger*, supra, t ___ F2d ___, 59 LRRM 2043, to the effect that retired ersons provided coverage must have been employed by n employer who contributed to the Trust on their work fully satisfied.

(b) Qualified Retired Persons are "Employees" within Meaning of Statute.

Section 302 (c) (5) provides that the trust fund be

established "for the sole and exclusive benefit of the employees of such employer, and their families and dependents (or of such employees, families, and dependents, jointly with the employees of other employers making similar payments, and their families and dependents)." Like the District Court in the *Blassie* case, supra, the District Judge, here, considered that this language precluded the extension of health and welfare benefits to retired painters, even though they had previously been covered by the Plan through employer payments to the Trust. However, this reasoning is unsound because, as pointed out by the Court of Appeals, in *Blassie v. Kroger Co.*, supra, the statutory language does not mean that employee benefits are to be confined to the period of an employee's active employment. Obviously, some of the benefits recognized as permissible by the statute would not, by their very nature, be received while the recipient was an active employee. We refer here to unemployment benefits, disability and sickness or accident insurance, vacation pay, severance pay, and, of course, pensions.

The Court of Appeals, in the *Blassie* case, at ___ F2d ___, 59 LRRM 2041, observed:

> "The trend of welfare plans toward the inclusion of retired persons is a fact of today's industrial life which needs no documentation here."

Also, in this connection, see "Health Benefit Plans Under Collective Bargaining" (Defendants' Ex. 23) and the Monthly Labor Review article on page 841 of Defendants' Exhibit No. 15.

(c) Comparison with Internal Revenue Code and Regulations.

The language used in Section 302 (c) (5) of the Labor Management Relations Act of 1947 is almost identical with the provisions of the Internal Revenue Code. Section 165 of the Internal Revenue Code of 1946 conferred a tax-exempt status upon a "trust forming part of a stock bonus, pension, or profit-sharing plan of an employer *for the exclusive benefit of his employees or their beneficiaries* * * *." (Emphasis supplied) Under this statute, the federal tax regulation then applicable made it clear that the word "employees" included former employees." Regulations 111, Section 29.23, (p) 1, provided as follows:

> § 29.23(p)-1 *Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; in general.* [Emphasis in original.] Section 23(p) prescribes limitations upon deductions for amounts contributed by an employer under a pension, annuity, stock bonus, or profit sharing plan, or under any plan of deferred compensation. *It is immaterial whether the plan covers present employees only, or present and former employees, or only former employees.* Section 23(p) does not cover contributions which give the *em-*

> *ployee or former employee* present benefits such as life insurance protection. The cost of such benefits is deductible to the extent allowable under this section 23(a). See § 29.165-6. [Emphasis supplied.]

Again this history was relied upon by the Court of Appeals in *Blassie v. Kroger Co.*, at ___ F2d ___, 59 LRRM 2042, wherein the Court stated:

> "Some precedent is perhaps afforded by the fact that those provisions in the Internal Revenue Code which, for income tax exemption, require that a pension or welfare trust be 'for the exclusive benefit of his employees' have been administrativley interpreted to include former employees."

The Court also stated, at ___ F2d ___, 59 LRRM 2041

> 'Benefits after retirement are not an evil at which the statute was directed."

III.

THE DISTRICT COURT ERRED IN FINDING (R. 80, l. 15-20) THAT BENEFITS PRESENTLY PAID TO RETIREES AND THEIR WIVES ARE PROVIDED FOR BY "EXTRA ASSESSMENTS" NOW BEING PAID BY EMPLOYERS

As we have shown, no retired painter is being provided benefits unless he has been a covered employee under the Plan prior to his retirement. Also, the ev

dence established that at the time of trial the Trust had a "surplus" of "a little over $200,000" (Tr. 96, l. 25 to Tr. 97, l. 4). The collective bargaining agreement (Plaintiff's Ex. 1, p. 27) provided for employer payments of 12 cents per hour worked by each employee until January 1, 1964, and for payments of 15 cents per hour for the remainder of the term of the agreement. There was absolutely no evidence produced that any moneys had been obtained by the Medical Trust by "extra assessments" levied on the employers. This would not have been possible under the collective bargaining agreement (Plaintiff's Ex. 1) or the Medical Trust Agreement (Plaintiff's Ex. 4) and we therefore respectfully submit that this finding was improper and should not have been made. We contend, of course, that in any event the validity of the providing of benefits to retirees under the qualifying requirements established by the trustees is perfectly clear.

IV.

THE DISTRICT COURT ERRED IN FINDING THAT IT WOULD BE A "CRIMINAL OFFENSE" FOR THE APPELLEE TO MAKE PAYMENTS TO THE MEDICAL TRUST AND THE PENSION TRUST, AND IN DENYING APPELLANTS' MOTION TO AMEND THE JUDGMENT.

Here, we contend, of course, that the provisions of the trust agreements in the particulars attacked by ap-

pellee were perfectly lawful and that employer payments called for by the collective bargaining agreement to each of the Trusts also are perfectly lawful. In addition, it would appear that the terminology used in the judgment (R. 87, l. 1-6), in stating that the appellee "would be guilty of a criminal offense" in making the payments is improper, in that it amounts to a pre-judgment of the penal provisions of Section 302. Section 302 provides for penalties for *wilful* violations only. We submit that there was no occasion in this civil proceeding to make such a determination relative to the penal sanctions.

V.

THE DISTRICT COURT ERRED IN ENJOINING THE TRUSTEES OF THE PENSION TRUST AND THE TRUSTEES OF THE MEDICAL TRUST FROM COLLECTING PAYMENTS FROM THE APPELLEE, AND IN FAILING TO ENTER JUDGMENT IN FAVOR OF THE RESPECTIVE TRUSTEES OF EACH TRUST ON THEIR COUNTERCLAIMS

If the District Court was in error in finding that Section 302 was violated by permitting coverage of Union employees or by extending benefits to retired employees, the trustees of the two trusts automatically would be entitled to recover judgment on their counter

claims. The amount due from the appellee to the appellant trustees of the Pension Trust for the period May 1, 1963, through August 31, 1964, was agreed to be $177.55 (R. 63, 1. 20-27). Similarly, it was agreed that if the appellant trustees of the Medical Trust were entitled to recover judgment against the appellee, the amount owed was $251.83 for the period from May 1, 1963, through August 31, 1964 (R. 63, 1. 27-32). The respective trust agreements provided for liquidated damages in the sum of $10.00 a month or 10% of the contributions owed, whichever is the greater, where employers failed to file reports or make payments to the Trusts (Plaintiff's Ex. 2, p. 11, and Plaintiff's Ex. 4, pp. 10-11). Here, the plaintiff admitted in the pretrial order that he had failed to file reports or make payments to either Trust since April, 1963 (R. 63, 1. 20-22). Consequently, under the formula above set forth, the appellee is liable to the trustees of each Trust in the sum of $160.00, as liquidated damages for the period involved.

CONCLUSION

In conclusion, the appellants respectfully submit that it is clear that neither the provisions of the two trust agreements permitting coverage of Union employees, nor the practices of appellants in this connec-

tion violate the statute; that it is also clear that the extension of benefits to qualified retired employees does not violate the statute; that therefore the judgment of the District Court should be reversed with respect to these matters and the cause remanded, with directions to enter judgment in favor of the appellant trustees on their counterclaims.

Respectfully submitted,

PAUL S. HYBERTSEN

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GREEN, RICHARDSON, GREEN & GRISWOLD

Attorneys for Appellants.

I certify that, in connection with the preparation of his brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

DONALD S. RICHARDSON
Of Attorneys for Appellants

APPENDIX

Page of Transcript of Record Showing Exhibits

Exhibit Number	*Identified*	*Offered and Received*
Plaintiff's:		
No. 1	10	10
No. 2	10	10
No. 3	10	10
No. 4	10	10
No. 7-A through 11-A	92	92
No. 13	85	86
No. 14	86	86
No. 15	87	87
No. 16	134	134
No. 25	133	133
No. 26	88	88
No. 27	88	89
No. 28 through 32	128	130
No. 33	134	134
No. 40	19	20
No. 41 through 43	11	12
No. 45 and 46	12	13
No. 48	161	162
No. 49	11	12
Defendants'		
No. 1	97	98
No. 2 and 2-A	135	136
No. 3	139	139
No. 4	140	140
No. 5	132	132
No. 6	99	100
No. 7	101	101
No. 8	100	100-101
No. 9 through 12	135	135
No. 14-A	124	124

No. 14-B	125	125	
No. 15	136	136-137	(as offer of proof)
No. 16	103	104	
No. 17 through 19	149-150	150-151	
No. 20	101-102	102	
No. 21	102	102-103	
No. 23	137	137	
No. 24	98-99	99	

No. 20068

United States
COURT OF APPEALS
for the Ninth Circuit

JIM GARVISON, G. E. CHINN, W. DON CAWOOD, CECIL SEAVEY, W. T. BOYD, H. C. RADATZ, CLIFFORD E. HINES and ROBERT E. DAVIS, TRUSTEES OF OREGON AND SOUTHWEST WASHINGTON PAINTERS PENSION TRUST FUND; E. W. SHIELDS, FRED PETERSON, EARL DILTS, JACK ROPER, W. T. BOYD, H. C. RADATZ, CLIFFORD E. HINES and ROBERT E. DAVIS, TRUSTEES OF OREGON AND SOUTHWEST WASHINGTON PAINTERS MEDICAL-HOSPITALIZATION TRUST FUND; PORTLAND AREA PAINTERS AND DECORATORS JOINT COMMITTEE, INC., a non-profit Oregon corporation; and LOCAL NO. 10 OF THE BROTHERHOOD OF PAINTERS, DECORATORS & PAPERHANGERS OF AMERICA,

Appellants,

v.

NORMAN A. JENSEN,

Appellee.

APPELLEE'S BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY, Judge

ARTHUR S. VOSBURG,
FRANK McK. BOSCH,
VOSBURG, JOSS, HEDLUND & BOSCH,
909 American Bank Building,
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STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 7-65

SUBJECT INDEX

and the Declaratory Judgment Act, 28 U.S.C.A. 2201. This court has jurisdiction under 28 U.S.C.A. 1291.

STATEMENT OF THE CASE

Appellee cannot accept the proposition that this case involves two typical trusts and that all this court has to decide is the abstract question of (a) whether it is permissible under Section 302 of the Labor Management Relations Act for a labor union to provide coverage for its employees by making payments to a jointly administered medical trust and to a pension trust; and (b) whether it is permissible for a medical trust to provide medical benefits for retired employees who were beneficiaries of the plan prior to retirement. We do not believe that the problem is that simple but that a detailed examination of the facts and documentary evidence is necessary. Hereafter in this brief plaintiff's exhibits will be referred to as "Ex. —", defendants' exhibits as "Defend. Ex. —," and the collective bargaining agreement, plaintiff's Ex. 1, as the "contract" and the page numbers of exhibits will be inclusive.

Factual Background and Discussion of Pertinent Documents

The basic instrument in this controversy is the Contract, Ex. 1., which is an agreement entered into by "chapters" representing members as employers and "unions" representing members as employees." In addition individual painting contractors not members of any chapter, hereinafter referred to as "non-member

signatories" and so referred to in Ex. 1, could become parties to the Contract by proper application to the appropriate local joint committee and by signing a document agreeing to be bound by all the terms thereof. The procedure to be followed is set forth in Ex. 1, Article X, pp. 35-36. Plaintiff was not a member of any chapter and became bound by the Contract by executing the appropriate document, Defend. Ex. 14a and 14b, dated February 19, 1962. It should be noted that at the time plaintiff executed Defend. Ex. 14a and 14b the two trust indentures had not been formulated and that plaintiff was not a member of any chapter.

Ex. 1 is one of a series of collective bargaining agreements between the same parties and clearly indicates that it was executed for the sole purpose of establishing the working relationship between employers and their employees and not for the benefit of the Unions and their officers.

"PURPOSE

The purposes of this Agreement are to establish harmonious relations and uniform conditions of employment and a Medical-Hospital Plan and Pension Plan between the parties hereto, to promote the settlement of labor disagreements by conference and arbitration, to prevent strikes and lockouts, to utilize more fully the facilities of the Apprenticeship Training and Promotion Program.

"To Promote efficiency and economy in the performance of Painting and Decorating work, to formulate and establish Joint Committees as directed under Article IX in this Agreement, and generally to encourage a spirit of helpful coopera-

tion between the Employer and Employee groups to their mutual advantage and the protection of the investing public." Ex. 1, p. 3.

Further:

"The term 'Employer' shall be defined to mean any individual, firm, co-partnership, or corporation whose principal business is that of painting and decorating or drywall application and who shall employ at least one journeyman and who shall at all times maintain a permanent address as a principal place of business." Ex. 1, Article II, p. 4.

Besides the usual provisions for wage and working conditions Ex. 1 provides by Article VIII for certain "Fringe Benefits": a Medical-Hospitalization Plan, Section 1, p. 27, and a Pension Plan, Section 2, p. 28, both of which trusts, when formulated, are incorporated into Ex. 1 by reference.

The Medical-Hospitalization Plan requires each employer to pay a certain sum per hour per man into a trust. The Pension Plan provides that every employer "as defined herein" is obligated to pay a certain sum per hour per man into the trust. The third paragraph provides for deposit into escrow of the agreed contributions, the terms of the trust not having been agreed upon at the time Ex. 1 was formulated.

In addition to providing certain fringe benefits, the Contract provided for the formation of local joint committees (Ex. 1, Article IX, pp. 30-35). Local joint committees, of which defendant Portland Area Joint Com-

mittee is the joint committee having territorial jurisdiction in the geographic area in which plaintiff operated his business, consisted of six members, three representing the employers and three representing the Unions. Expenses were to be borne equally but actually all funds were provided by the employers and were derived from the issuance of shop cards, Agreed Facts, par. 7, p. 4, R. 60. Besides providing the machinery whereby employers not members of Chapters could become parties to the Contract as hereinbefore explained, one of the functions of joint committees was to provide funds for the enforcement of "this Contract" and "the amount incurred for legal fees and expenses in connection with the above matters . . . as well as the cost and expenses of any disciplinary committee in connection with the administration of this Agreement, and for such other expenses as may be incurred in connection with causing the observance of this Agreement by the parties hereto," (Ex. 1, pp. 30-31). Thus the local joint committee was the vehicle designated for enforcing the provisions of the Contract, including the Pension and the Medical Trusts. The provisions of this Contract providing for the formation of a Medical Trust specifically charge the local joint committee "with the responsibility of carrying out the enforcement of contributions," Ex. 1, Article VII, last full paragraph, p. 27. Further, the joint committee was authorized to settle local disputes and grievances and to discipline the employers and the members of the Unions.

In addition the local joint committee was charged with the duty of issuing certain "official identification

2 was finally executed, employers and the Unions were at loggerheads over the question of business reprentatives participating in the Pension Trust, the negotiators being H. C. Radatz and W. T. Boyd of Local 10, Clifford E. Hines of Local 360, and Robert E. Davis of 1277, all business representatives, with Roy C. Hill in the background (Tr. 20-26). According to Lowell A. Brown, the coverage of business representatives was resisted by the employers because not agreed to under Ex. 1 and because of illegality, and insisted on by Roy C. Hill. It is clear that the Union negotiators were only interested in allowing business representatives to participate.

From January 22, 1962 until the trust was finally set up on December 15, 1962, contributions agreed to be made by the employers were deposited under an escrow agreement with the United States National Bank. On August 6, 1962, on the refusal of Lowell A. Brown to provide forms on which the Unions could make deposits into the escrow, Local 10 secured a regular employer remittance form and made a retroactive deposit into the escrow for six months, Ex. 28aa (Tr. 30-34). This was followed by retroactive deposit by Local 360, Ex. 29w on August 20, and by retroactive deposit by Local 1277, Ex. 31-u on August 23d (Tr. 34-35). Local 724 did not contribute to the Pension Trust until September, 11, 1963, when Ralph V. Allison became business representative, Ex. 30-l and 30-m, because Roy C. Hill refused to allow Don Lange, business representative, to participate (Tr. 49-50). Local 1902 did not begin to contribute until March 16, 1963, when Roy

J. Dell became business representative and made retroactive contributions for the period from December 1, 1962 through February 28, 1963, Ex. 32-k to 32-m.

Since Locals 10, 360, 1277 and 1902 were making payments into the escrow along with the employers and this condition could continue indefinitely because of the adamant position of the business representatives, the employers capitulated and the Pension Trust indenture was executed December 15, 1962 (Tr. 34-37).

For the period from January 22, 1962, when Exhibit A became effective, to date all contributions made by the participating Unions into the Pension Trust, with minor exceptions, some explained and some unexplained, were for the benefit of the business representatives of the participating Unions and in addition Local 10 made contributions for the benefit of Robert E. Lewis, Financial Secretary. All of these participants were officers of the Union (Ex. 45 and 46). No formal notice of election by the Unions to cover any specific person was ever given to the trustees by the Union, the monthly reports showing contributions for specifically named individuals being deemed sufficient. The rules and regulations for the Pension Plan, Ex. 3, provide for pensions beginning January 1, 1965. Employees of the Unions and employees of employers had the same rights both as to past service credit and contributory service credit. Otherwise the document is unimportant.

The Medical Trust, Ex. 4

A Medical Trust had been in existence since May 13, 1953, see preamble Ex. 4, p. 1. Unions were given the right to elect to cover their "officers, representatives and employees" on the same terms as regular employees under the "Amended Memorandum to Trust Agreement" dated March 20, 1957. See Defend, Ex. 8, Amended Memorandum to Trust Agreement, p. 2, so that employees of Unions were being covered by a Medical Trust on January 22, 1962, and even though the Medical Trust, Ex. 4, was not executed until December 15, 1962, no administrative problems arose, since the Unions continued to make payments to the existing trustees for their employees at the fixed rate of $13.50 per employee per month, and the employers continued to make payments to the existing trustees but at the increased rate per man per hour of 12c as provided by Ex. 1.

While the legality of covering Union employees under the Medical Trust was questioned by the employers, it would appear that the main controversy was over the coverage of business representatives of the Unions under the Pension Trust, probably because Union employees were being covered under the existing trust. In any event both trust documents were agreed upon December 15, 1962.

The present Medical Trust provides coverage for two categories of employees, namely:

> "Section 2. EMPLOYEE. The term 'employee' as used herein shall mean any painter, decorator,

drywall taper or paperhanger who is represented by the Union as defined herein and is employed by an employer as defined herein.

Section 3. ASSOCIATE EMPLOYEES. The term 'associate employees' shall mean employees of the Union and employees of employers who are outside the bargaining unit represented by the Union and whom the Union or employer elects to cover under this trust fund on a uniform non-selective basis, as determined by the Trustees. Associate employees shall also include employees represented by the Union that are employed by federal, state and municipal governments or agencies or subdivisions thereof." Ex. 4, Article I, Sections 2 and 3, p. 2.

The first category, "employee," covers all painters, paperhangers, etc. actually doing the manual work, there being various types of employers. Irrespective of type of employer, all these employers paid into the trust fund at the rate of 12¢ per hour per man during 1962 and 1963 and 15¢ per hour during 1964. This was a contractual obligation prescribed by Ex. 1. As to category two, "Associate Employees," employees of Unions and employees of employers outside the bargaining unit such as clerical help, etc., coverage was at the whim of the Union and the employer. The Union and the employer had no contractual obligation whatsoever to provide coverage for this class of employee and each had the right to elect just what employees should be covered, the only limitation being that they must be within the definition of "Associate Employee."

Ex. 4 provides for a different scale of payment for associate employees from the rate per hour fixed by Ex. 1, namely:

> "(i) Enter into contracts or procure insurance policies . . ., and to terminate, modify or renew any such contracts or policies and to exercise and claim all rights and benefits granted to the Trustees or the fund by any such contracts or policies. Any such contract may be executed in the name of the fund, and any such policy may be procured in such name.
>
> (j) Establish and fix a monthly amount to be contributed to the fund for and on behalf of 'associate employees'. Such amount shall be commensurate with the insurance premium charged to provide insurance coverage for employees within the bargaining unit. The Union, however, may elect to make payments on an hourly basis in the same amounts as provided by the collective bargaining agreement for those employees who occupy positions in which they directly participate in the furtherance of the business of the Union, as distinguished from clerical or stenographic employees." Ex. 4, Article III, Section 1 (i) and (j), pp. 6-7.

Thus, the Unions, besides having the option as to what officers and employees should be covered, also had the option of covering their employees either on a flat fee $13.50 per month during 1962, or at the employer rate, 12¢ per hour per man during 1962, except that as to clerical help coverage must be at the flat fee rate.

Locals 10 and 360 elected to cover their officers,

treasurer, and business representative at the flat fee rate, Ex. 7a-cc and Ex. 8a-cc.

Locals 724 and 1902 elected to cover their business representatives on a per hour basis, Ex. 9a-m and 11-a-n.

Local 1207 first elected to cover its business representative on a per hour basis and then on March 8, 1963 shifted to a flat fee, Ex. 10a-cc.

On the basis of 180 hours per man per month payments on a per hour basis would amount to $21.60 per month as against a flat fee of $13.50. This disparity became larger in 1964 when the rate advanced to 15¢ per hour. According to Joseph H. Herrle there was an advantage to the beneficiary if payments were made on an hourly basis as the beneficiary would have automatic coverage for six months if his employment was terminated. Joseph H. Herrle further testified that the flat fee per month payments generally covered the insurance cost, although occasionally there was a lag in raising the flat fee contribution to equal increased premium charge.

As disclosed by Ex. 7a-7cc, 8a-cc, 9a-n, 10a-r and 11a-n, contributions were made to the Medical Trust by the same Unions and on behalf of the same people as were made by these Unions to the Pension Trust, except that Local 10 contributed to the Medical Trust for the benefit of Thelma Corson, Jean Taylor and Patricia Nelson, stenographers, and likewise contributed for the benefit of Roy C. Hill from May 1, 1962 through October, 1963, Ex. 7a-7u, even though his employment by Local 10 was terminated June 1, 1962.

Coverage for Retired Employees and their Wives under the Medical Trust

The present industry contract, Ex. 1 and its two predecessors, Defend. Ex. 4 and 3, in providing for the creation of a medical trust made no reference to coverage for retired employees. The claim by appellants of the right to cover retired employees is based on a resolution of the trustees dated January 15, 1958, Defend. Ex. 7, wherein retired employees were to be given the identical coverage provided for working members. This resolution was subject to *ratification* by the local Unions and the employers' association. There is no evidence of such ratification but on June 1, 1958, a rider was attached to the existing insurance policy which was signed by six of the eight trustees, Defend. Ex. 24. While the resolution, Defend. Ex. 7, provided that retired employees were to be given the identical coverage provided for working members, the coverage actually provided for these retirees was less extensive than that provided for working employees.

As heretofore pointed out, the Medical Trust Agreement, Ex. 4, was not agreed upon until December 15, 1962, and makes absolutely no reference to coverage for retirees. During the period from April 15, 1962 to December 15, 1962, while the Medical Trust indenture was being negotiated, there was no discussion between the employers and employees as to coverage for retirees and in fact Lowell A. Brown and at least one of the then existing trustees representing the employers, William E. Walker, did not know that the retirees were actually being covered. While Ex. 4 purports to be an

amendment to the previous trust indenture, it was complete in itself and would supersede all resolutions such as the resolution of January 15, 1958, Defend. Ex. 7, so that there is absolutely no basis for present coverage of retirees.

Appellee raised this point of lack of authority in the Pretrial Order, Plaintiff's Contentions 3, p. 5, R. 60, as follows:

> "3. That, contrary to the provisions of the Contract (Plaintiff's Exhibit 1) and the Medical Trust Indenture (Plaintiff's Exhibit 4), the Medical Trust is providing certain medical benefits for retired painters and their dependents who meet the qualifications outlined in the Hospital-Medical Plan (Plaintiff's Exhibit 5) . . . "

Since the resolution of January 15, 1958 was never ratified by any Union or by any Chapter the execution by six of the eight trustees of the insurance rider providing limited coverage for retirees effective June 1, 1958, Defend. Ex. 24, was wholly unauthorized and null and void. Further, even if the resolution of January 15, 1958 had been ratified as required, the Contract, Ex. 1, formulated approximately April 15, 1962, and the Medical Trust Indenture, executed December 15, 1962, would supersede and render nugatory all resolutions of the trustees and plans promulgated by the Administrator that were inconsistent therewith. A reference to the Medical Trust Indenture, Ex. 4, Sections 3 and 4, p. 2, shows that it provides coverage for two definite classes of employees, neither of which could possibly include the retirees.

The trial court could have and this court could well stop here and hold the practice of providing coverage for retirees void for lack of authority. We believe that if this court proceeds to express an opinion on the abstract question of whether coverage is permissible for retirees under a Medical Trust it will in effect be determining a moot question.

Admittedly the trial court did not pass on the question of authority but it likewise did not pass on the broad abstract issue discussed by appellants and the various amici curiae in their briefs, but, as we shall point out later in this brief, based his opinion on a very narrow factual finding, which may explain the failure to rule on the question of lack of authority raised by appellee at the trial.

General Approach

With reference to active Union employees participating in trusts we have three District Judges: Roy W. Harper, Chief Judge of E. D. Missouri E. D., Eighth Circuit, in *Kroger* v. *Blassie,* 225 F. Supp. 300, and *Local No.* 688 v. *Townsend,* 229 F. Supp. 417; Dudley B. Bonsal, S. D. New York, Second Circuit, in *United States Trucking Corporation* v. *Strong,* 299 F. Supp. 937; and John F. Kilkenny, District of Oregon, holding that such participation is illegal. On the other hand we have three Circuit Judges of the Eighth Circuit: Marion C. Matthes, Harry A. Blackman, and Albert A. Ridge, holding to the contrary, 345 F(2)58 and 345 F(2)77. On participation in a medical trust by retirees *United States Trucking Corporation* does not deal with

the subject and the ruling of Judge Kilkenny was limited to a particular situation—otherwise the divergence of opinion is the same.

The Circuit Judges in *Blassie* v. *Kroger,* 345 F.2d 58, say that they prefer "to approach our present task with a construction policy favoring inclusion and benefits where there is no positive statutory language or inference of exclusion, rather than one favoring exclusion and a denial of benefits where there is no positive language of inclusion," thus totally disregarding the decisions of the Supreme Court and the plain language of the statute and totally ignoring the holdings, particularly in the Ninth Circuit, that the trustees are "representatives" of the employees. We believe that this court should interpret the statute, since there is no ambiguity, in accordance with its plain English meaning as illustrated by decisions of the Supreme Court and this court.

The first two specifications of error, 1 and 2, deal with the legality of the Unions providing coverage for their officers and other employees under a medical and a pension trust and are dealt with under one heading by appellants. We shall do likewise, taking the negative of their Summary of Argument.

I
ARGUMENT

Section 302 of the Labor Management Relations Act of 1947, 29 USCA 186, prohibits any employer from paying or any representative of any employees from

receiving money or things of value except under certain circumstances, subsection (c), of which the first four provisions are not pertinent to this inquiry. Subsection (c)(5) contains the exceptions which appellants contend and appellee denies allow Unions to contribute for their officers and employees. The controlling language is:

"(a) It shall be unlawful for any employer . . . to pay . . . money . . .

(1) To any representative of any of his employees who are employed in an industry affecting commerce . . . .

* * * * *

(c) The provisions of this section shall not be applicable . . .

(5) with respect to money or other thing of value paid to a trust fund established by such representative for the *sole and exclusive benefit of the employees of such employer,* and their families and dependants (or of *such* employees, families and dependents jointly with the employees of other employers making similar payments, and their families and dependents): Provided, That (A) such payments are held in trust for the purpose of paying, either from principal or income or both, for the benefit of employees, their families and dependents, for medical or hospital care, pensions on retirement or death of employees, compensation for injuries or illness resulting from occupational activity or insurance to provide any of the foregoing, or unemployment benefits or life insurance, disability and sickness insurance, or accident insurance; (B) the detailed

> basis on which such payments are to be made is specified in a written agreement with the employer, and employees and employers are equally represented in the administration of such fund, together with such neutral persons as the representatives of the employers and the representatives of employees may agree upon . . . . "

In *Blassie* v. *Kroger,* supra, the circuit court, in dealing with a medical trust, simply held that there was nothing in the statute that would bar participation "of genuine non-officer employees of the Union and that this agreements coverage of the employees is not improper" and then went on to say that coverage for officers if on no better basis than afforded others would not be improper. Assuming that a pension trust was involved, the ruling would undoubtedly be the same. Now in the instant case who are the participants in the Pension Trust? As far as defendant Local 10 is concerned the participants were the four business representatives and the financial secretary, all officers of the local, and two journeymen when they attended a Union covention. As far as the other Unions are concerned it was the business representatives and some minor unexplained coverage for other individuals. As far as the medical trust is concerned the same people were covered and in addition from time to time three stenographers were covered by Local 10. Just who are the representatives of the industry employees and who are the representatives of the Union employees in the administration of the two trusts? It is the business

representatives, officers of the Unions, who negotiated the terms of the two trusts for their own personal benefit and these same four business representatives ended up as employee trustees under both trusts. Further, under the Pension Trust the determination as to who should participate was not only decided by the Union but was restricted to those who participated in the "furtherance of the business of the Union . . . as distinguished from clerical and stenographic employees." Under the Medical Trust coverage likewise depended wholly on the whim of the Union and in actual practice we find the same coverage as in the Pension Trust for officers and coverage by Local 10 of three stenographers. Would the Eighth Circuit under this set of facts find that the trusts were not in conflict with the Act?

The brief of appellants and particularly the briefs of the various amici curiae make intensive reference to Congressional debate and the Internal Revenue Code and regulations thereunder. We say once and for all that so far as participation in either trust by officers of the Unions is concerned, such reference has no bearing on our problem. Nowhere in any debate can we find any reference to coverage for Union officers and it would come as a distinct shock to the Congressmen who enacted the original Act in 1947 to learn that they had created a law which would allow Union officers acting as representatives of the employees of the industry in question to negotiate trusts in which they were the main beneficiaries so far as the Unions were concerned and then acting as trustees for themselves.

Moreover, the comfort that the Eighth Circuit takes in the Internal Revenue Code, Section 165(a)(3) B and (4) of the 1939 Code and Section 401(a)(3) B and (4) of the 1954 Code, which, in allowing an exempt status, permit the inclusion of officers if there is no discrimination in their favor is a two-edged sword. If there is no discrimination between the officers and other employees the Trusts do not violate the Act, but what if there is discrimination such as here where the only persons participating in the Pension Trust are the business representatives and the financial secretary—in fact coverage for menial employees is forbidden, and where the Union has the power to select whom it may choose for coverage in the Medical Trust and selects the business representatives, and in the case of Local 10 not only the business representatives but ex-business representative Roy Hill, and some clerical help, with the Unions empowered to give and in at least two instances, giving, a better deal to their officers than to clerical help, viz., making payments on an hourly basis rather than a flat fee (See Ex. 4, Article III (j) p. 6). This is a clear-cut case of discrimination and on the reasoning of the Eighth Circuit the Trusts violate the Act and are illegal.

Apart from the plain and unambiguous language that "employees of such employers . . . or . . . jointly with the employees of other employers making similar payments . . . ." means simply industry employees, cases interpreting the Act lead to the same conclusion. That the trustees, or at least the employee trustees, were representatives of employees and that the term

did not refer to "exclusive bargaining representatives" of employees, was enunciated by Judge Learned Hand and quoted with approval by the Supreme Court in *U. S.* v. *Ryan,* 350 U. S. 299, 76 S. Ct. 400, 100 L. Ed. 335 (1956):

> "We agree with Judge Hand that in using the term 'representative' Congress intended that it include any person authorized by the employees to act for them in dealing with their employers."

All cases subsequent thereto are in accord. We specifically call attention to two decisions of this Circuit:

Sheet Metal Contractors v. *Sheet Metal Workers,* 248 F.2d 307; Cert. denied 355 U.S. 924, 78 S. Ct. 367, and

Local No. 2 v. *Paramount Plastering,* 310 F.2d 179. Cert. denied 372 U.S. 944.

In *Sheet Metal* this court said at page 315:

> "It is said that the trustees were not representatives of employees because they were trustees of a welfare fund, and were not acting as representatives of either union or employees since they had fiduciary duties in connection with a trust fund. We think that a mere reading of §302 demonstrates the fallacy of any such position. If that section, as Essex suggests, means that 'trustees of a fund' are for that reason not representatives within the meaning of the Act, then part 5 of subdivision (c) was wholly unnecessary and all the careful statement of an exception found there would be wholly meaningless. For the exception does not follow from the mere fact that there are trustees of a fund, but the fund must be subject to

all the detailed limitations there stated. But the decision in United States v. Ryan brushed away all such narrow notions of the meaning of the term 'representatives' as that used in Essex."

We also refer the court to *Arroyo* v. *United States,* 359 U.S. 419, 3 L. Ed. (2) 915, 79 S. Ct. 864 (1959) which clearly holds that the Congress intended to define "with specificity" the lawful purposes of a Section 302 trust; to *U. S.* v. *Ryan,* 350 U.S. 299, 100 L. Ed. 335, 76 S. Ct. 400 (1956), which holds that any trust not coming under the express letter of the exception is "malum prohibitum"; to *Upholsterers' International* v. *Leathercraft Furniture,* 82 F. Supp. 570 (E.D. Pa. 1949) which approves the contention that a trust does not come within the exception unless it is for the "sole and exclusive benefit of employee members"; and to *U. S. Trucking Corporation* v. *Strong,* 239 F. Supp. 937. While *U. S. Trucking* v. *Strong,* supra, is a decision of a District Court, the reasoning of the court in holding a provision of a pension trust providing for participation by Union employees as well as employees of the industry was illegal is interesting and persuasive since it attacks the problem from a viewpoint different from that of most of the cases. The court called attention to the fact that collective bargaining becomes a snare and a delusion if the employer is allowed to sit on both sides of the bargaining table and that for the same reason a labor organization may not sit on both sides of a bargaining table if it be deemed an employer for the purpose of a pension trust. It must act solely for the industry employees it represents; for it to

act in its official capacity as an employer would present a conflict of interest. The court further concluded:

> "Under the facts here, the Union is acting as a labor organization and not as an employer.
>
> "Since the Union is a labor organization and not an employer for the purposes of Section 302 (c)(5), the exemption of Section 302 (c)(5) does not apply, and payments by the trucking company employers to the Pension Fund, and the receipt thereof by the Trustees, violate Section 302(a) and (b) ** * * It is conceded that the Pension Fund and its Trustees are, for the purposes of Section 302, 'representatives' of the trucking companies' employees. Indeed, the reasoning in Ryan and the holdings in the subsequent cases of Mechanical Contractors Ass'n of Philadelphia v. Local Union 420, 265 F.2d 607 (3rd Cir. 1959) and Local No. 2 of Operative Plasterers and Cement Masons Int'l Ass'n v. Paramount Plastering, Inc., 310 F.2d 179 (9th Cir. 1962) would require the Court to reach such a conclusion even if the issue were in dispute.
>
> "For the foregoing reasons, the Court holds that the Pension Fund does not come within the exemption of Section 302(c)(5) and therefore payments by employers to the Trustees of the Pension Fund violate Section 302(a). From the effective date of the judgment to be entered herein it shall be unlawful for the plaintiff to make payments to the Trustees or for the Trustees to accept such payments so long as the Union participates as an 'employer' in the Pension Fund." P. 941

And, finally, we believe the reasoning of Judge Harper in *Kroger* and *Townsend* and of Judge Kilkenny in the

instant case, is far more compelling than that of the Circuit Court for the Eighth Circuit.

The argument that Union business representatives and financial secretaries come from the rank and file membership of the Unions and therefore if there were no pensions no one would want to become a business representative is fallacious. In the first place an employee of the rank and file wants to become a business representative because it is a better job and not such hard work, and if the Union wishes to provide an incentive all Unions affiliated with the AFL-CIO can set up their own pension and medical trusts just as some other Unions do. The argument that there has been no abuse of the two trusts is questionable where we have Roy Hill covered long after his official status with Local 10 had been terminated and four business representatives occupying the status of both trustees and beneficiaries in both trusts. We quote from *Local No.* 2 v. *Paramount Plastering, supra,* at p. 186 and 191:

> "It is perfectly true, as the union contends, that there is not the slightest hint in the record that any of the trust funds here involved 'has resulted in bribes, kickbacks, slush funds, racketeering or union war chest; nor do [plaintiffs] assert that this fund is under the sole control of the union.' We accept that statement with gratitude and happiness that it is true. But that does not prove that the trust fund is 'not within the scope of the evil which Congress intended to eliminate.' We agree with appellees and Employing Plasterers' Association of Chicago v. Journeyman Plasterers'

Protective & Benevolent Society of Chicago, supra, wherein the court stated:

" 'Section 302 is aimed primarly at the *prevention* of possible abuse and not at providing a remedy for abuse actully perpetrated. * * * Where it is established that payment and acceptance is between employer and "representatives" of employees, the issue in a suit for injunction becomes the legality of the welfare funds *as measured by* the statutory standards of administration.' (279 F.2d at 97.) (Emphasis added.)" p. 186

"We do not quarrel in the slightest with the laudable objectives of the trust amicably created by labor and management in this case. We sympathize with the efforts of both labor and management to solve a vexing industry problem. But like so many of such present day problems, our duty is to rule in accordance with that which the Congress (quote) in its wisdom (end of quote) has seen fit to enact. We cannot widen the door when the door sill has been carefully tailored by the representatives in Congress. The relief sought by the appellants herein must be found in congressional and not judicial action." p. 191

The coverage of Union employees in a Pension and Medical Trust does not fall within the exception (c)(5) of the Act, particularly where coverage is at the whim of the Unions, is grossly discriminatory, and is devised for all practical purposes to benefit the Union officers who negotiated the Trust Indentures.

II

The District Court did not err in finding that the practice of extending certain benefits to retired employees by the Trustees of the Medical Trust violated Section 302 of the Labor Managment Relations Act of 1947

and

Did not err in finding (R. 80, 1.15-20) that the benefits presently paid to retirees are provided for by extra assessments now being paid by employers.

Appellants have treated their Specification of Error 3 under the converse of the first of the above headings as II and their Specification of Error 4 under a separate subsequent converse heading denominated III. We will treat both of these specifications together and deem a further review of the factual situation necessary.

As heretofore stated, coverage for retirees was first provided June 1, 1958, Defend. Ex. 24, and we have heretofore pointed out that in our opinion this coverage and all subsequent coverage was unauthorized and null and void. If this court agrees with us, that is the end of the subject, but if the court believes that it is obligated to render an opinion on the actual practice now being followed by the Medical Trust, as illustrated by the rider, Defend. Ex. 24, it is necessary to consider further facts relative to this coverage. The amount of the payment to the insurance company to provide the cost of covering retired employees and their wives was obtained by figuring what the cost would be for these retirees: 61 in 1962, Ex. 26, 57 retired men and 35

cost of coverage after retirement. Now the Unions say that the test is solely whether the retiree was a *participant in the Plan prior to retirement* and that whether or not a portion of the payments made to the trust while the retiree was actively employed was or was not in contemplation of providing coverage after his retirement is immaterial. Certainly under all the labor agreements before this court: Ex. 1; Dedend. Ex. 4, dated February 1, 1956; Defend. Ex. 3, dated January 19, 1959; the Trust Indentures, Ex. 4; Defend. Ex. 8, dated March 20, 1957; and amendment thereto dated March 20, 1957, there is not the slightest indication that present contributions were to be made to provide a fund for medical care of active employees on their retirement. We believe that the distinction between a medical trust whereby contributions are made by present industry employers for present industry employees to create a fund to provide medical care of the employees when they retire is far different from the situation where we have a medical trust providing for medical coverage for active industry employees only and superimposed thereon is a practice of covering retired employees. But we have a surplus sufficient to take care, as least to a limited extent, of the medical needs of retirees, so why not provide at least limited coverage, particularly since the cost thereof amounts to only $1.517 per month for 1964 as against $13.883 for active employees? The answer, of course, is that the Contract and Trusts provide for no such coverage, and the surplus is intended to protect the active employees from rising medical costs, and if excessive, the benefits to active employees should be increased. The

line of argument thus adopted by the Unions takes care of the objection that the retirees would not fall within the definition of employees of employers set forth in the Act, but certainly it is not applicable under the factual situation as found by the trial court in this case.

It is possible that this court will believe that the factual situation on which the trial court based its conclusion of law, namely, present payment by employers for the benefit of retired former employees was illegal because at the time of payment the beneficiaries were not employees, and the situation where employers create a trust fund not only for the benefit of the present active employees but also for the benefit of these same employees on their retirement so that they are employees at the time payment is made is a "distinction without a difference." In any event it is true that in *Blassie* coverage was extended to retirees in June 1957, although the original trust was created in 1953 and that in *Townsend* the trust was created for the sole purpose of providing medical care for employees on retirement.

If this court believes there is no distinction the question then resolves itself into whether to follow the reasoning of Judge Harper or that of the Eighth Circuit which in effect is a holding that the word "employees" should be interpreted as including "former employees." To us the reasoning of Judge Harper is compelling, the reasoning of the Circuit Court a strained construction in order to achieve what that court conceives is a desirable effect.

We have heretofore mentioned that we were not im-

pressed with reference to the Internal Revenue Code and regulations made thereunder, particularly the exemptions of the Trusts from taxation as heretofore in this brief discussed, and have pointed out that the Medical Trust does not treat the officers of the Unions and the menial employees equally but is discriminatory in favor of the officers. As to the reference in the brief for Amalgamated Meat Cutters to the 1962 amendment to Section 401 of the Internal Revenue Code of 1954, it is noteworthy that the provisions for medical benefits for retired employees is tied in with a pension and annuity plan and not with provisions for medical and hospital care. Further, it provides for something that will occur in the future, namely, payment into a fund for the benefit of present employees to become effective on their retirement. Moreover, a statute dealing with tax exemptions is a civil statute and it is irrelevant to the interpretation of a criminal statute. Even if it were proper to consider a later civil statute as aid to interpreting a prior criminal statute, the amendment to Section 401 of the Internal Revenue Code by the Act of 1962 merely states that a pension or annuity plan may provide for the payment of medical benefits on retirement and only relates to determining whether contributions thereto may be deducted for income tax purposes.

Appellants' contentions when extended to their logical conclusions mean that any purpose beneficial to employees, present or past, would be proper so long as the management thereof is vested equally in employers and employees. If this were the case there would have been no point in the enumeration of specific purposes

which was so carefully included in the Act, particularly considering the fact that the Act is a criminal statute which must be strictly read and construed. Even in 1959 when the Act was amended to include a sixth category, pooling vacations, holidays, severance, etc., there was no wide enlargement of the permitted activities. With particular reference to retired employees the Act as written can only be read that retired employees do not fall within the specific exceptions mentioned, and that it is ridiculous to refer to subsequent legislation as showing the intent of Congress in 1947 when the language used is plain and unequivocal.

III

Claimed error in finding that payments into either Trust by Appellee would be a criminal offense

The above is Specification of Error 5 and is treated by appellants under IV.

As far as the finding that appellee would be guilty of a criminal offense in making payments to the two trusts is concerned appellee had been warned that he would be committing an illegal act and this was the basis of absolving him from payment. See

Employing Plasterers v. Journeymen Plasterers, 279 F.2d 92 (Seventh Circuit 1960).

International Longshoremens v. Seatrain Lines, 326 F.2d 916 (Second Circuit 1964).

Mechanical Contractors v. Local Union 420, 265 F.2d 607 (Third Circuit 1959).

Substantial penalties are involved: a $10,000.00 fine or imprisonment for one year, or both.

payment of the requisite fees therefor. The second point is that in the event the court holds that appellants or any of them are entitled to recover on their counterclaim they cannot recover in addition to the principal amount 10% of this amount due as liquidated damages, as liquidated damages are only allowed when the actual damages are uncertain or difficult to ascertain and never as a penalty in addition to the actual damages sustained. See *Yuen Suey* v. *Fleshman,* 65 Or. 606, 133 P. 803.

On the question of coverage for retirees we again emphasize that this court should not follow the beckoning of appellants and embark on a judicial excursion in a sea of abstract principles but should simply hold that the practice of covering retirees was unauthorized. However, if the court believes that it should determine the legality of coverage its decision should be based on the factual situation as found by the trial court and the practice held illegal. Finally, if this court believes that there is no difference in principle between this case and *Blassie,* the reasoning of Judge Harper should be followed. In any event the holding in *Townsend* should be no authority since there we have the situation where present contributions are being made on behalf of active employees to provide a fund for one specific purpose: to provide medical benefits for these employees after retirement.

We represent an individual with limited resources and as a result this brief is meager as opposed to the plethora of briefs by amici curiae which we simply cannot answer—in fact this brief is largely taken from the

brief presented to the trial court. We suggest that in the event the judgment herein is upheld either wholly or in part, since we are determining the validity of a trust, the trustees, who are only interested in determining what is legal as distinguished from what is illegal should be required to pay an attorney's fee for appellee.

Respectfully submitted,

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I certify that in connection with the preparation of this brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

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of Attorneys for Appellee

No. 20068

In the

United States Court of Appeals

For the Ninth Circuit

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vs.

NORMAN A. JENSEN, *Appellee.*

APPELLANTS' REPLY BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY, *Judge*

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DAILY JOURNAL OF COMMERCE
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STATUTE CITED

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vs.

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Appellee.

APPELLANTS' REPLY BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY, *Judge*

REPLY TO APPELLEE'S "FACTUAL BACKGROUND AND DISCUSSION OF PERTINENT DOCUMENTS"

As stated on page 4 of our opening brief, this case presents two primary questions for determination by the court:

(a) Whether it is permissible, under the provisions of Section 302 of the Labor Management

Relations Act of 1947, 29 USCA §186, for a labor union to provide coverage for its employees, including its officers, by making payments to a jointly administered medical trust and to a pension trust.

(b) Whether it is permissible, under the provisions of Section 302 of the Labor Management Relations Act of 1947, 29 USCA § 186, for a jointly administered medical trust to provide, through insurance, medical and hospital benefits for retired employees who were beneficiaries of the Plan prior to their retirement and upon whose work employer parties to the collective bargaining agreement had made payments to the trust.

It appears that, since the Court of Appeals for the Eighth Circuit has answered both of these questions in the affirmative in *Blassie v. Kroger Co.*, 345 F2d 58 (1965) and in *Local No. 688, International Bro. of Teamsters v. Townsend*, 345 F2d 77 (1965), the appellee in this case now seeks to cloud the real issues with irrelevant matter in his extended "factual background" material. We submit that this material is all irrelevant to the real issues involved and, consequently, we will limit our discussion of this portion of appellee's brief to a few matters wherein we feel that otherwise an erroneous impression might be created.

Appellee has placed some emphasis upon the point that he was not a member of any chapter of the employer organization when he first became bound by Plaintiff's Exhibit 1, the contract which requires that payments be made to the two trusts (Appellee's Brief

p. 3). While this obviously makes no difference insofar as the legal questions involved are concerned, it should be noted that the plaintiff testified that he did thereafter and on January 1, 1963, join the Mt. Hood Chapter of the Painting and Decorating Contractors of America (Tr. p. 125-126). This was subsequent to the adoption of both trust agreements. The two trust agreements (Plaintiff's Ex. 2 and 4) were executed by Mr. A. E. Boone, who was the president of the Mt. Hood Chapter in 1962 (Tr. 118).

Appellee states that the "local joint committee" was the vehicle designated for enforcing the contract, including the pension and medical trusts (Appellee's Brief p. 5). Whether this is accurate or not is completely immaterial, because the respective trustees each have the authority and the duty to take any action necessary to enforce payment of the contributions due from employers (Plaintiff's Ex. 2 p. 11, Plaintiff's Ex. 4 p. 10). Thus the medical trust and the pension trust clearly operate independently from the "joint committee" and must proceed with whatever legal action might be necessary to collect contributions.

Appellee's discussion in his brief on pages 7 and 8 of what the witness Brown contended preceding the adoption of the pension trust agreement (Plaintiff's Ex. 4) is likewise irrelevant. Since the real question is simp-

ly whether it is permissible under section 302 of the Labor Management Relations Act for union employees to participate in such a trust, it matters not how the fund agreement was arrived at nor who may have insisted that the trust agreement provide for such participation. Moreover, the witness Murphy, president of the Oregon Council of Painting and Decorating Contractors of America, at the time the contract and trust agreement were negotiated testified that Brown had no authority to negotiate on either the contract or the trusts (Tr 158-159).

Appellee on page 13 of his brief seeks to create an erroneous impression in comparing the amounts paid to the medical trust by employers on an hourly basis and by some employers for their non-bargaining unit employees and by some of the unions for their employees on a monthly basis. He points out that at one time the "flat fee" was $13.50 and makes a comparison between a monthly payment based upon 180 hours at 12c an hour, or $21.60, with the $13.50 figure. Appellee overlooks several important considerations in making this comparison. First, there is no evidence that the average painter works 180 hours each month and, second, it is well known that particularly in this industry employment is not regular. Employees working at this trade simply do not average nearly "180 hours per man

per month." Under the plan an employee must have 100 hours to his credit to be covered, and for each month of coverage 100 hours is deducted from his reserve (Tr. 105-106). Appellee's statements might suggest that, in effect, employers were paying $21.60 per month for coverage for all employees in the bargaining unit, as against the "flat fee" of $13.50. This, of course, is not true. The employers simply paid 12c per hour for each hour worked, until the rate was increased to 15c per hour in 1964. Whether a given employee is covered or not depends upon whether he has a sufficient reserve of hours to provide him with coverage. When the "flat fee" method is used, the amount necessary to cover the premium is paid and the employee concerned is covered for the month involved, whether he be a union employee or one of the employer's employees not within the bargaining unit.

Appellee has placed some emphasis upon the continuance of coverage by Local 10 of Roy Hill after he left his office in Local 10 (Appellee's Brief pp. 13, 25). Of course, the evidence established that during this period Mr. Hill had no claims; in other words, that no medical or hospital benefits were paid to him (Tr. 146). Consequently, the trust could not possibly have been adversely affected in any way by the fact that the union mistakenly continued to make the flat fee payments on Mr. Hill.

REPLY TO APPELLEE'S ARGUMENT CONCERNING RETIRED EMPLOYEE COVERAGE

Appellee claims that the trustees did not have authority to adopt the coverage for retired employees under the trust agreement. This same question was raised in *Blassie v. Kroger Co.*, 345 F2d 58, 70. In the *Blassie* case the trust agreement had contained an initial reference to retired persons and this reference was deleted by a subsequent amendment in 1958. The Court of Appeals for the Eighth Circuit, nevertheless, ruled that the extension of coverage to retirees was not prohibited by the trust agreement, reasoning that the term "employees" relates to the time of contributions rather than to the time of possible enjoyment of benefits (345 F2d at 71). We submit that the question of the meaning of the term "employee" is the same under section 302 of the statute as under the trust agreement. In other words, if it is proper for benefits to be extended to persons who were covered by the plan prior to their retirement under the statute because they are "employees" within its meaning, they are also "employees" under the trust agreement.

The retiree coverage was provided in 1958 under the terms of the trust document then in existence (defendants' Ex. 8). In that trust agreement the term "employees" was defined as follows:

"EMPLOYEES shall mean any Painter, Decorator, or Paperhanger and any other Employee covered by the existing Labor Agreement represented by the Unions, who is employed by any signatory Employer, *or any other employee or employees agreed upon by a majority vote of the Trustees.*" (Emphasis added)

There was absolutely no evidence to indicate that nyone who participated in the preparation or adoption f the 1962 amended trust agreement (Plaintiff's Ex. 4) or the medical trust intended to eliminate the coverage or retired employees which had been in effect since 958. This coverage had been in effect during the imediately preceding contract between the employers nd the union (Defendants' Ex. 3) and for part of the ontract which preceded defendants' Exhibit 3 (Defendnts' Ex. 4), and there is nothing to indicate that there as any intent on the part of any of the parties negotiatg the contract (Plaintiff's Ex. 1) to eliminate this overage. This part of the plan was placed into effect y the board of trustees composed of both employer epresentatives and employee representatives and two ollective bargaining agreements were negotiated thereafter with the plan and the coverage remaining in effect hroughout this period of time. Certainly, under these rcumstances, no further formal ratification by either de need be expected or required.

As appellee has pointed out on page 30 of his brief, the cost of the retiree benefits is nominal ($1.517 per month) when compared to the cost of benefits for active employees ($13.883 per month). Regardless of this fact, our position is that the extension of coverage to retirees here was lawful for the same reasons stated by the Court of Appeals in *Blassie v. Kroger Co.*, supra. Here the plan for retirees more than satisfies the requirements set by the court in the *Blassie* case. Not only must the retirees have been covered under the plan prior to retirement but five other pertinent requirements must be met for a retiree to receive benefits (see Appellants' Opening Brief, pp. 18-19).

With respect to the court's finding that retiree benefits are paid for from "extra assessments," this is incorrect because the employers simply pay to the medical trust the fixed hourly amounts established in the contract. Also, at the time of trial, it was established that there was a surplus in this trust in excess of $200,000.00 (Tr. 96-97).

It should be kept in mind that the medical trust has existed since 1953 (Tr. 76) and has been continued because successive collective bargaining agreements have provided for payments to this trust. The appellee points out that in the *Blassie* case the retiree coverage was extended in 1957, although the original trust was created

n 1953 (Appellee's Brief p. 31). In the present case the nedical trust also began in 1953, and retiree coverage vas commenced in 1958 (Tr. 98-99). The similarity)etween the cases in this respect is obvious. We submit hat the reasoning of the court in *Blassie v. Kroger Co.*, upra, is sound and directly applicable to the instant ase.

REPLY TO APPELLEE'S ARGUMENT CONCERNING UNION EMPLOYEE COVERAGE

In discussing this matter, appellee infers that some ind of discrimination or favoritism for union officers nder the two trusts has been established. Appellee oints to the coverage of union business representatives s though there is something unusual or evil about this, nd apparently infers that someone else ought to be overed. The point, of course, is that the business repre-ntatives and, in the case of Local 10, the financial ecretary are men who would be working at the trade nd thereby enjoying coverage under both trusts, if they ere not holding union offices. This is the reason for ie language contained in section 1 of Article I of the ension trust agreement (Plaintiff's Ex. 2) limiting un-)n employee coverage to those who occupy positions ther than clerical or stenographic. This is also the eason why the medical trust permits payments by the nion on an hourly basis on non-clerical employees

(Plaintiff's Ex. 2, pp. 6-7). Under the medical trust, the union, like the painting contractors, can contribute on stenographic help. The fact that stenographic employees are not subject to coverage under the pension trust nor paid on on an hourly basis to the medical trust certainly does not make either trust "grossly discriminatory" (Appellee's Brief p. 26). It must be noted that both trusts have been approved by the Internal Revenue Service (Tr. 132, Defendants' Ex. 5; Tr. 99-100, Defendants' Ex. 6).

We submit that appellee's claim of discrimination is an afterthought, made now because of the decisions of the Court of Appeals in the *Blassie* and *Townsend* cases. The pretrial order (R. 60-74) does not include any contention by appellee that either trust was "discriminatory." In the District Court the issue was confined to whether union employee coverage was permissible under section 302. In any event, neither the provisions of the trust agreement nor the practices are discriminatory — the unions are permitted to provide coverage by paying for it, and the union employees receive the same benefits as other employees. There is no evil here which Congress sought to prohibit by enacting section 302.

Appellee has pointed out that the employee trustees are also covered beneficiaries under each trust. Again there is nothing unusual or wrong about this. Under

each trust agreement the employee trustees are appointed by the local unions (Plaintiff's Ex. 2, p. 9; Plaintiff's Ex. 4, p. 8). Should the union select four trustees who are employed by painting contractors, the situation would be the same as that which appellee criticizes, in that these persons would be both trustees and beneficiaries. Nothing in section 302 disqualifies an employee-beneficiary from serving as a trustee.

APPELLANTS' COUNTER CLAIMS

As shown in our opening brief (Appellants' Brief p. 25), the amounts due from the plaintiffs to the respective trusts are stipulated. It seems perfectly clear that if the appellee's contentions with respect to the legality of participation by union employees and of coverage of retired employees are incorrect, then the trustees of the respective trusts are entitled to recover the contributions due from the plaintiff.

As the appellee has recognized (Appellee's Brief, p. 5), the District Court found that the provisions of the contract relating to local joint committees were separable from the remainder of the contract, including the provisions for employer payments to the pension trust and the medical trust (R. 77-78). The savings and separability clause in the present contract (Plaintiff's Ex. , p. 35) reads as follows:

> "If any provision of this Agreement is declared invalid, or applicability thereof to any person, circumstance, or thing is held invalid, the validity of the remainder of this Agreement and/or applicability to any person, circumstance or thing, shall not be affected thereby."

We believe that the District Court's finding in this respect is sound. This result is supported by the decisions of the United States Supreme Court in *NLRB v. Rockaway News Supply Co.*, 345 US 71, 97 L ed 832, *Ebinger Baking Co. v. Bakery & Pastry Drivers & Helpers*, 194 F Supp 617, and *Eldridge et al v. Johnston*, 195 Or 379, 245 P2d 239.

In the *Rockaway News* case, the United States Supreme Court stated, at 97 L ed 838, as follows:

> "The total obliteration of this contract is not in obedience to any command of the statute. It is contrary to common-law contract doctrine. It rests upon no decision of this or any other controlling judicial authority. We see no sound public policy served by it. Realistically, if the formal contract be stricken, the enterprise must go on — labor continues to do its work and is worthy of some hire. The relationship must be governed by some contractual terms. There is no reason apparent why terms should be implied by some outside authority to take the place of legal terms collectively bargained. The employment contract should not be taken out of the hands of the parties themselves merely because they have misunderstood the legal limits of their bargain, where the excess may be severed and separately condemned as it can be here."

Just as in the *Rockaway News* case, supra, decided by the Supreme Court, it is important here that the terms of the contract governing painters' wage rates, medical benefits, pension benefits and other conditions of employment be maintained as bargained for by the parties.

LIQUIDATED DAMAGES

Appellee contends that appellants cannot recover liquidated damages as outlined in the trust agreement, in addition to the principal amount of contributions due, upon the grounds that liquidated damages are only allowed when the actual damages are uncertain or difficult to ascertain, and never as a penalty in addition to the actual damages sustained.

In this connection, the pension trust agreement (Plaintiff's Ex. 2, at page 11) provides as follows:

> "Section 3. Liquidated Damages. The parties recognize and acknowledge that the regular and prompt filing of employer reports and the regular and prompt payment of employer contributions to the Fund is essential to the maintenance in effect of the Pension Plan, and that it would be extremely difficult, if not impracticable, to fix the actual expense and damage to the Fund and to the Pension Plan which would result from the failure of an individual employer to make such reports and to pay such monthly contributions in full within the time provided above. Therefore, the amount of damage to the Fund and Pension Plan resulting from failure to make reports or pay contributions within the time

specified shall be presumed to be the sum of $10.00 or 10% of the amount of the contribution or contributions due, whichever is greater, for each delinquent report or contribution. These amounts shall become due and payable to the Fund as liquidated damages and not as a penalty, upon the day immediately following the date on which the report or the contribution or contributions become delinquent. In addition, if any delinquent payment remains unpaid for a period of six months, the Trustees may then assess, as additional liquidated damages 6% of the total amount then delinquent. However, the Trustees in their discretion for good cause (and the Trustees shall have the sole right to determine what shall constitute good cause) shall have the right and power to waive all or any part of any sums to the Fund as liquidated damages."

The medical trust agreement (Plaintiff's Ex. 4, at p. 10) contains a similar provision. The question for the court to determine is simply whether the amounts sought by the defendant trustees in addition to the monthly amounts which the plaintiff has failed to pay constitute "liquidated damages" or are in fact "penalties."

Here the parties in each trust agreement have recognized that the trusts will sustain damages, the amount of which would be very difficult to ascertain if employers failed to file the proper reports and make the proper payments. Obviously the parties were simply recognizing the existence of actual facts. It is clear that each

trust would be required to investigate and take appropriate action when employer reports and payments are not made, and the exact cost of this extraordinary effort, which would have to be performed cannot be specifically determined. These are the reasons for the adoption of the liquidated damages provision in each trust agreement.

Moreover, it is manifest that trusts of this nature cannot function without prompt payments of the required contributions, and it is obvious that the failure of employers to promptly pay the required contributions would seriously impair the functioning of the trusts. It is well settled that in the determination of this problem the court should consider all of the circumstances which surround the parties, together with the ease or difficulty of measuring the breach in damages. A comparison of the size of the stipulated sum, not only with the value of the subject matter of the contract but also with the problem of the probable consequences of the breach as they appeared when the contract was executed, should be considered. See *Secord v. Portland Shopping News et al*, 126 Or 218, 224, 269 P 228.

The *Secord* case further indicates that "Where the damages are uncertain and speculative, the presumption ordinarily is that the parties have taken that into consideration in making the contract, and have agreed upon

a definite sum to be paid in case of a breach, in order to put the question beyond dispute and controversy and to avoid the difficulty of proving actual damages." Certainly the sums fixed as liquidated damages are most modest, in consideration of the probable consequences of a breach by one or more employers and the application of the rules outlined in the *Secord* case clearly indicates that such sums were agreed upon as liquidated damages and do not in fact impose a penalty.

APPELLEE'S REQUEST FOR ATTORENYS' FEES

Counsel has suggested that, should the court uphold the judgment below, either wholly or in part, the appellant trustees should be required to pay an attorneys' fee for appellee. This case was commenced and tried as an adversary proceeding. Appellee has cited no statutory or other authority to support his suggestion. In the absence of a contractual obligation, attorneys' fees may not be awarded unless a statute provides for them. See *Cereghino et al v. State Highway Comm.*, 230 Or 439, 451, 370 P2d 694.

CONCLUSION

In conclusion, the appellants respectfully submit that the judgment of the District Court should be reversed and the cause remanded with directions to enter judgment in favor of the appellant trustees on their counter claims.

Respectfully submitted,

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I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

PAUL S. HYBERTSEN

Of Attorneys for Appellants

No. 20068

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JIM GARVISON, et al.,

Appellants,

vs.

NORMAN A. JENSON,

Appellee.

BRIEF OF AMICI CURIAE, THE TRUSTEES OF MOTION PICTURE INDUSTRY PENSION PLAN; I.A.T.S.E. BASIC CRAFTS-GUILDS — HOLLYWOOD PRODUCERS HEALTH AND WELFARE FUND FOR THE EMPLOYEES OF THE MOTION PICTURE AND ALLIED INDUSTRIES; SCREEN ACTORS GUILD — PRODUCERS PENSION PLAN; SCREEN ACTORS GUILD — PRODUCERS WELFARE PLAN; DIRECTORS GUILD OF AMERICA — PRODUCER PENSION PLAN; AND PRODUCER-WRITERS GUILD OF AMERICA PENSION PLAN; IN SUPPORT OF APPELLANTS.

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PRELIMINARY STATEMENT

This brief is limited primarily to the following point urged by *amici curiae:*

Since subsection (c)(5) of Section 302 of the Labor Management Relations Act, as amended, is an exception to a criminal statute, proper application of the rules of statutory construction requires that the

terms of the exception be construed liberally so as to resolve any ambiguities or uncertainties therein in favor of inclusion within the exception, particularly where, as in the instant case, to do so would in no way defeat the obvious purposes of Congress in enacting Section 302.

This Court is being asked to determine the meaning of the words "employees" and "other employers" as used in subsection (c)(5) which is an exception to Section 302 of the Labor Management Relations Act, as amended, 29 U.S.C. §186.* We believe that such words can be defined in appellants favor by resort to the clear meaning of the words as used in the Act, keeping in mind the general rule of statutory construction that where the same word is used in different parts of a statute it is to be presumed that, in the absence of anything indicating a contrary intent, the word is used in the same sense throughout. *United States v. Gertz,* 249 F.2d 662, 665 (9th Cir. 1957); *Schooler v. United States,* 231 F.2d 560, 563 (8th Cir. 1956).

Thus, for example, the word "employer" is defined in Section 2(2) of the Act as including a labor organization "when acting as an employer." The Supreme Court has held that the word "employer" as used in Section 9 of the Act includes a labor organization so that its employees may exercise their Section 7 rights to bargain collectively. *Office Employees Union v. N.L.R.B.,* 353 U.S. 313 (1957). There is no indication whatever in

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* This statute will hereinafter be referred to as "the Act."

Section 302 that the word "employer" as used in Section 302(c)(5) was intended to be different from its definition and use in other sections of the Act wherein unions are included when acting as employers of their employees. Furthermore, there is no provision in Section 302 which indicates that the trust itself cannot be an employer when acting with respect to its employees. Our position is fully supported by the decisions of the Eighth Circuit Court of Appeals in *Blassie v. The Kroger Company*, No. 17598, ... F.2d ..... (8th Cir. April 23, 1965) 59 LRRM 2034 and *Local No. 688, International Brotherhood of Teamsters v. Townsend*, No. 17710, ... F.2d ..... (8th Cir., April 23, 1965) 59 LRRM 2048.

Similarly, we think that the word "employees," which is broadly defined in Section 2(3) of the Act as including "any employees," necessarily includes former employees and retired employees. That such an interpretation is required is, we think, made clear by the fact that Section 302(c)(5)(A) and (6) implicitly acknowledge the fact that the word "employees" as used in the opening sentence of subclause (5) is not limited to actively working employees. Thus, an employee receiving such benefits as severance pay, unemployment benefits or disability benefits is not an actively working employee, but is a former employee and is nevertheless clearly within the term "employees" as used in Section 302, and the statute does not set forth any limitation with respect to when such former employee ceased to be actively employed. Moreover, there is no language limiting the term "employee" so as to indicate an intended exclusion of union employees or trust employees.

Here again, the decision of the Eighth Circuit Court of Appeals in *Blassie v. The Kroger Company, supra,* and *Local No. 688, International Brotherhood of Teamsters v. Townsend, supra,* support our conclusions.

We assume, however, for purposes of the argument which follows, that this Court may reach the conclusion that neither the wording of the statute nor its legislative history clearly resolves the issues and that there exists uncertainty and ambiguity in regard to the meaning of the disputed words. Under such circumstances this Court must determine whether it is appropriate to apply a rule of strict or liberal construction in resolving the uncertainty.

The District Court did, of course, give consideration to rules of statutory construction in rendering its decision. This is made particularly evident by Judge Kilkenny's reference to the familiar rule that "exceptions in statutes must be strictly construed and limited to the objects fairly within their terms. . . ." (Opinion of the District Court, p. 5, Record, p. 79) As will be more fully discussed, we believe that the District Court erred in its general approach in that it apparently did not give proper consideration to the character of the statute it was dealing with, which is of a criminal rather than remedial nature.

It is significant to note that in its recent decision in *Blassie v. The Kroger Company*, No. 17598, ... F.2d ..... (8th Cir. April 23, 1965) 59 LRRM 2034, reversing 225 F. Supp. 300 (E.D. Mo. 1964), the Eighth Circuit Court of Appeals expressly adopted a liberal

approach in interpreting the same provision and words of Section 302(c) here in dispute. The court, discussing its "general approach", stated as follows:

> ". . . We recognize that the Supreme Court, in Arroyo v. United States, supra, at p. 424 of 359 U.S., said, as to §302, 'We construe a criminal statute'. See also United States v. Ryan, 350 U.S. 299, 305 (1956). We are aware, too, that in Arroyo a bare majority went on to say that 'a literal construction of this statute does no violence to common sense', that the majority gave the statute a narrow application to the facts there presented, and that the minority stated, p. 433 of 359 U.S., 'Section 302(b) is in all practical effect repealed'. Arroyo, however, was an appeal from the affirmance of a judgment of a conviction in a criminal case.
>
> "We are concerned here, instead, with requested civil relief under §302(e). We do not believe that in this posture the Supreme Court majority in Arroyo would rigidly pursue the strict construction which a criminal statute customarily receives. We would prefer to approach our present task with a construction policy favoring inclusion and benefits where there is no positive statutory language or inference of exclusion, rather than one favoring exclusion and a denial of benefits where there is no positive language of inclusion." (.....F.2d at .....)

We agree with the Eighth Circuit Court of Appeals that a liberal construction is appropriate, as we do with

its decision on the issues here in dispute. In support of the liberal construction adopted by the Eighth Circuit Court of Appeals we present for the Court's consideration an alternative rationale upon which this Court should hold that a liberal statutory construction favoring appellants in the construction of the disputed words contained within the exceptions to Section 302 is in order.

ARGUMENT

SINCE SUBSECTION (c) (5) OF SECTION 302 OF THE LABOR MANAGEMENT RELATIONS ACT, AS AMENDED, IS AN EXCEPTION TO A CRIMINAL STATUTE, PROPER APPLICATION OF THE RULES OF STATUTORY CONSTRUCTION REQUIRES THAT THE TERMS OF THE EXCEPTION BE CONSTRUED LIBERALLY, SO AS TO RESOLVE ANY AMBIGUITIES OR UNCERTAINTIES THEREIN IN FAVOR OF INCLUSION WITHIN THE EXCEPTION, PARTICULARLY WHERE, AS IN THE INSTANT CASE, TO DO SO WOULD IN NO WAY DEFEAT THE OBVIOUS PURPOSES OF CONGRESS IN ENACTING SECTION 302.

A. Exceptions to Criminal Statutes Should be Liberally Construed In Favor Of Inclusion Within The Exception.

Section 302 is a criminal statute. The Supreme Court has so held on two occasions. *Arroyo v. United States,* 359 U.S. 419, 424 (1959); *United States v. Ryan,* 350 U.S. 299, 305 (1956).

It is a fundamental rule of statutory construction that criminal statutes are to be strictly construed.* *Commissioner v. Acker*, 361 U.S. 87, 91 (1959); *Arroyo v. United States*, 359 U.S. 419, 424 (1959); *Federal Communications Commission v. American Broadcasting Co., Inc.*, 347 U.S. 284, 296 (1954); *United States v. Wiltberger*, 5 Wheat 76, 94-95 (1820).

In the course of applying the rule of strict construction of criminal statutes, courts have explained its meaning in various ways. For example, it has often said that the rule requires that ambiguities or uncertainties be interpreted strictly against the state and liberally in favor of the accused. See e.g. *United States v. Resnick*, 299 U.S. 207, 209 (1936); *North American Van Lines v. United States*, 243 F.2d 693, 696 (6th Cir. 1957); *United States v. Thompson*, 202 F. Supp. 503, 507 (N.D. Cal. 1962); *United States v. Pepi*, 198 F. Supp. 226, 229 (D.Del. 1961); *United States v. Wells*, 176 F. Supp. 630, 632 (S.D. Texas 1959). Other courts explaining operation of the rule have held that criminal statutes are to be strictly construed "against the imposition of criminality and in favor of lenity." See e.g. *Ladner v. United States*, 358 U.S. 169 (1958); *Smith v. United States*, 233 F.2d 744, 746 (9th Cir. 1956).

Application of the rule of strict construction to criminal statutes is well illustrated by the language of the Supreme Court in *Ladner v. United States*, 358 U.S. 169 (1958),

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* Strict construction has been defined as ". . . the close and conservative adherence to the literal or textural interpretation." Crawford, *Statutory Construction* (1940) p. 450.

wherein the court was faced with two potentially reasonable but diverse interpretations of the meaning of the term "assault" as used in 18 U.S.C. (1940 ed.) §254:

> "Neither the wording of the statute nor its legislative history points clearly to either meaning. In that circumstance the Court applies a policy of lenity and adopts the less harsh meaning. '[W]hen choice has to be made between two readings of what conduct Congress has made a crime, it is appropriate, before we choose the harsher alternative, to require that Congress should have spoken in language that is clear and definite. We should not derive criminal outlawry from some ambiguous implication.' *United States v. Universal C.I.T. Credit Corp.*, 344 U.S. 218, 221-222. And in *Bell v. United States,* 349 U.S. 81, 83, the Court expressed this policy as follows: 'When Congress leaves to the Judiciary the task of imputing to Congress an undeclared will, the ambiguity should be resolved in favor of lenity.' " (358 U.S. at 177-178)

The generally accepted rationale underlying the rule of strict construction of criminal statutes "in favor of lenity" where uncertainty or ambiguity exists was first enunciated by Chief Justice Marshall in *United States v. Wiltberger,* 5 Wheat 76 (1820) as follows:

> "The rule that penal laws are to be construed strictly, is perhaps not much less old than construction itself. It is founded on the tenderness of the law for the rights of individuals; and on the plain principle, that the power of punishment is vested in the legislature, not in the judicial department. It is the legislature, not

the court, which is to define a crime, and ordain its punishment." (5 Wheat at 95)

While the phraseology used by the courts may differ, the underlying interpretation of the rule is at all times consistent — where a criminal statute may mean more than one thing and one meaning would find a violation while the other would not, then the rule of strict construction requires the court to reject the meaning which would find a violation.

The point here urged by *amici curiae* is that the rule of strict construction of criminal statutes requires that an exception to a criminal statute be construed liberally. This point is clearly and fully supported by both the rationale underlying the rule of strict construction for criminal statutes and the cases applying the rule, as heretofore discussed. Obviously, the two corollary rules are consistent. Where uncertainty exists in respect to applicability of a criminal statute to a particular situation then regardless of whether the final stamp of a violation is to be avoided by a strict construction of the general clause, or is to be avoided, as in the statute under consideration, by a liberal construction of an exception thereto, "the ambiguity should be resolved in favor of lenity," i.e., it should be interpreted liberally in favor of inclusion within the exception and strictly against a finding of a violation.

The specific issue of proper construction of exceptions to criminal statutes has not been subject to extensive discussion or analysis. This is perhaps understandable since criminal statutes generally are not written in the

manner of Section 302 which for all practical purposes makes criminality hinge on a failure to comply with the exceptions. However, such authorities as have considered the issues are in full support of *amici curiae's* contention.

For example in *United States v. Slaughter,* 89 F. Supp. 876 (D.C. 1950) the defendant was indicted for violation of 2 U.S.C.A. §267 which requires registration of persons engaged for pay in attempting to influence passage or defeat of legislation by Congress. An exception in the statute makes the general provisions inapplicable to any person appearing before a committee of Congress in support of or in opposition to legislation. In holding that the exception was not limited to witnesses who actually and physically appeared before a committee of Congress to give testimony but that it extended as well to persons, such as the defendant, who had helped prepare statements for witnesses who were to appear before a committee, the court said:

> "The statute is a criminal statute. It must be construed most favorably to the defendant in case of any doubt or ambiguity. To interpret the exception as being limited solely to the person who physically appears before the committee would frequently render nugatory and defeat the apparent intent of Congress . . .
>
> "These activities [preparing statements for witnesses] are clearly within the exception." 89 F. Supp. at 876-77.

A series of state court cases even more explicitly adopts the rule here urged by *amici curiae.*

For example, in *State v. Hill,* 189 Kan. 403, 369 P.2d 365 (1962), the Supreme Court of that State had occasion to comment upon rules of statutory construction applicable to exceptions to criminal laws in the context of an alleged violation of the Sunday sales law. The statute in question first prohibited all sales of "goods, wares or merchandise" but then excepted from its operational scope sales of "drugs or medicines, provisions, or other articles of immediate necessity." The court said:

> ". . . criminal statutes are to be strictly construed and courts should not extend them to embrace acts or conduct not clearly included within their prohibitions [case cited], *and exceptions in penal statutes are to be construed liberally in favor of persons charged with violations of the statutes . . .*" (Emphasis added) 369 P.2d at 372.

Similarly, in *Schuyler v. Southern Pac. Co.,* 37 Utah 591, 109 Pac. 458 (1910), affirmed 227 U.S. 601 (1912), the Supreme Court of that state in the course of interpreting the Hepburn Act (34 Stat. 584; Fed. Supp. 1907 p. 169) which makes it a criminal violation for common carriers to provide free transportation to persons unless within those classes of persons specifically excepted or for persons other than those designated in the exceptions to accept free transportation, held as follows:

> ". . . exceptions in penal statutes ought to be liberally construed in favor of him who is charged with the

violation of the provisions of the statute." 109 Pac. at 468.

In *State v. Cunningham,* 111 S.E. 835 (S.Ct. App. W.Va. 1922) the court was required to interpret a state penal statute known as the "Worthless Check Act." A proviso in the statute forbid prosecution if payment on the "worthless check" was made within twenty days from that on which the drawer "receives actual notice, verbal or written of the protest" of the check. Noting that a determination of the constituent elements of the offense created by the statute involved consideration of the proviso as well as its other parts, the court liberally interpreted the proviso explaining as follows:

> "The liberal construction here given to the proviso, in restraint of the operation of the terms of the main or penal clause of the statute, is well founded in authority. In its entirety, the statute is construed favorably to the accused, the penal part, strictly, and the exception or restraining clause, liberally." 111 S.E. at 837.

Additional support for *amici curiae's* contention herein is to be found in various texts analyzing the rules of statutory construction. For example, in Crawford, *Statutory Construction* (1940) the author discussing the general principle of strict construction of exceptions notes as follows at pages 610-611:

> "Where, however, a criminal or penal statute is involved, the exception must receive a liberal construction in favor of the defendant."

Similarly, discussing construction of a proviso, the author, first noting that "where the enacting clause is general in its language and purpose, a proviso subsequently following, should be construed strictly, and so as to exempt no cases from the enacting clause which does not fairly and clearly fall within its terms," concludes as follows:

> "This general rule, however, will not always be applied. For instance, the proviso will be given a liberal construction, and the main clause of the statute given a strict construction, in criminal cases, in favor of the accused." (pages 607-608)

To the same effect see McCaffrey, *Statutory Construction* (1953) § 59, p. 122.

In 50 Am. Jur., Statutes Section 431, p. 452, it is again recognized that in dealing with exceptions a rule of strict construction is not always applicable:

> "There are some cases, however, in which exceptions are liberally construed. The latter rule has been applied to statutes subject to a strict construction."

In 82 CJS Statutes, Section 382, p. 893, the rule is more specifically set forth as follows:

> "In some circumstances exceptions in a statute may be liberally construed to serve the general legislative policy. Exceptions in a statute imposing burdens are to be liberally construed in favor of the public; exemptions from provisions of statutes which impose restrictions on the use of private property are liberally

construed, and all doubts are resolved in favor of the property owner; and *exceptions in a penal statute are construed liberally in favor of a person charged with a violation of the statute.*" (Emphasis added)

Thus, it may be seen that the rationale underlying the general rule of strict construction of criminal statutes has been consistently applied to require a liberal construction of the terms of exceptions to criminal statutes, such as the Court is here dealing with, so as to resolve ambiguities therein in favor of inclusion within the exception, as is here urged.

B. A Determination By The Court That The Rule Requiring Liberal Construction of Exceptions To Criminal Statutes Is Applicable Herein Would Not Be Inconsistent With Any Decisions Of The Supreme Court Or Of This Court.

As noted in the preliminary statement, in adopting a rule of strict construction to be applied to interpretation of the terms of the exception here in question the District Court relied in part at least on the general rule that,

> " . . . exceptions in statutes must be strictly construed and limited to the objects fairly within their terms, since they are intended to restrain or accept that which would otherwise be within the scope of the general language." (Opinion of the District Court, p. 5, Record p. 79)

In support of the rule as stated the District Court cited two decisions of this Court, *Rheem Manufacturing Co.*

v. Rheem, 295 F.2d 473 (9th Cir. 1961) and *Korherr v. Bumb*, 262 F.2d 157 (9th Cir. 1958).

The District Court erred, we respectfully submit, in having failed to take proper cognizance of the fact that in the cited cases this Court was not dealing with statutes of a criminal nature but rather with remedial statutes to which the rule of strict construction of exceptions is applicable.* Indeed in *Korherr v. Bumb, supra,* this Court specifically emphasized in its opinion that it was dealing with enforcement of a remedial statute (a California state mechanic's lien statute, CCP § 1190.1) and that being remedial in nature it should be liberally construed and words of exception thereto strictly construed to limit the exception. 262 F.2d at 162.

In *Rheem Manufacturing Co. v. Rheem, supra,* this Court dealt with an exception to § 16(b) of the Securities Exchange Act of 1934, as amended, which is a wholly remedial provision of the Act. Section 16(b) provides a means whereby a corporation or stockholder thereof may institute civil action to recover from "insiders" (beneficial owners, directors or officers) any profits realized by such persons from any purchase and sale or any sale and purchase of any equity security within any period of

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* Remedial statutes are those which, according to one definition, ". . . afford a remedy, or improve or facilitate remedies already existing for the enforcement of rights and the redress of injuries, and statutes intended for the correction of defects, mistakes and omissions in the civil institutions and the administration of the state." Sutherland, *Statutory Construction* (3rd ed.), §3302, p. 234-235.

less than six months. None of the criminal sanctions set forth in other portions of the Act are applicable to such transaction however, nor does the Act provide for any form of penalty over and above recovery of profits. Section 16(b) has been held to be a remedial provision. See *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2nd Cir. 1943).

In summary, decisions of this Court in *Rheem Manufacturing Co. v. Rheem, supra,* and *Korherr v. Bumb, supra,* in no way stand in the way of this Court's now adopting a rule of liberal construction when dealing with exceptions to criminal statutes.

The District Court in the instant case also relied on the decisions of the Supreme Court in *Arroyo v. United States,* 359 U.S. 419 (1959) and *United States v. Ryan,* 350 U.S. 299 (1956) in support of its decision to strictly construe the provisions of subsection (c)(5) of Section 302. Indeed the District Court apparently read those cases as *requiring* a strict construction of the welfare trust exemption. It is respectfully submitted that the District Court erred if it so read the cases.

For example, in *United States v. Ryan, supra,* the Court was not directly concerned with any of the exceptions to Section 302. Rather the Court was concerned with the definition of the term "representative" in Section 302(b) and it broadly construed the term as not being limited to "an exclusive bargaining representative" of employees, but as including any person authorized by the employees to act for them in dealings with their employers. The Court's conclusion was based upon its view of the

literal meaning of the term "any representative of any employees", as buttressed by consideration of the full text of Section 302, which in the view of the Court made it clear that Section 302 anticipated that a representative might be an individual. Furthermore, the Court's review of legislative history indicated to it that "a narrow reading of the term 'representative' would substantially defeat the congressional purpose." 350 U.S. at 304. Since both the wording of the statute and its legislative history *clearly* pointed to the definition of representative as adopted by the Court, there was obviously no need for nor did the Court in fact rule on any question regarding applicable rules of construction to a determination of the meaning of Section 302. Certainly the Court neither ruled nor intimated that the exceptions to Section 302 should be strictly construed since the exceptions were not directly involved in the case but were only referred to for the purpose of buttressing the Court's construction of the word "representative" as used in Section 302(b).

In *Arroyo v. United States, supra,* the Court did adopt a rule of strict construction in determining applicability of Section 302 to receipt and subsequent defalcation by a trustee of moneys paid by an employer "to a trust fund." The Court stated:

> "We construe a criminal statute. 'It is the legislature, not the Court, which is to define a crime, and ordain its punishment.' United States v. Wiltberger, 5 Wheat. 76, 95; United States v. Halseth, 342 U.S. 277; Krichman v. United States, 256 U.S. 363. We are mindful, of course, that, 'though penal laws are to be construed strictly, they are not to be construed

> so strictly as to defeat the obvious intention of the legislature.' United States v. Wiltberger, supra, at 95. As Mr. Justice Holmes put it, 'We agree to all the generalities about not supplying criminal laws with what they omit, but there is no canon against using common sense in construing laws as saying what they obviously mean.' Roschen v. Ward, 279 U.S. 337, 339." (359 U.S. at 424)

In holding that since the transaction was within the precise language of Section 302(c), i.e., paid to a trust fund, the act was not in violation of Section 302(b), the Court noted that "an examination of the legislative history confirms that a literal construction of the statute does no violence to common sense."

The fundamental error of the District Court in the present case was that of apparently interpreting the above quoted language of the Court as requiring a strict and literal construction of Section 302 in its entirety, whereas in fact the Court was again primarily concerned with the applicability of Section 302(b). The Court neither stated nor intimated that a strict and literal interpretation of the exceptions would be required. Indeed it was not concerned with the exception contained in Section 302(c)(5) except insofar as the legislative history underlying that section had bearing on the particular question of whether it was intended by Congress that defalcating trustees be held accountable under Section 302(b).

It is true of course that in the course of its discussion the Court did make specific comments about Section 302(c)(5) as follows:

> "Congress believed that if welfare funds were established which did not define with specificity the benefits payable thereunder, a substantial danger existed that such funds might be employed to perpetuate control of union officers, for political purposes, or even for personal gain. . . . To remove these dangers, specific standards were established to assure that welfare funds would be established only for purposes which Congress considered proper and expended only for the purposes for which they were established." 359 U.S. at 426.

It is submitted that in so stating the Court was not holding that in the event of ambiguity or uncertainty in interpretation of certain words in the exception, such as those here in question, that such uncertainty and ambiguity be dogmatically resolved by a literal, strict and perhaps unreasoned reading of the statute. Nor can such a holding or such reasoning in any way be imputed to any statement of the Court in *Arroyo* or elsewhere. The Court in *Arroyo* was fully cognizant of the fact that it was dealing with a criminal statute. Indeed it carefully heeded the appropriate rule of statutory construction in concluding that a strict and literal interpretation was in order in determining the applicability of Section 302(b) to the situation before it, thereby properly resolving the uncertainty in favor of the defendant and against finding a violation. Under such circumstances, it is inconceivable that the Court could be considered as having adopted a rule of strict construction to the exceptions to a criminal statute thereby resolving the uncertainty against the defendant and in favor of finding a violation.

It is in order to briefly comment upon a decision of this Court which may be brought into question. We do not read this Court's decision in *Local No. 2 v. Paramount Plastering, Inc.*, 310 F.2d 179 (9th Cir. 1962), affirming 195 F. Supp. 287 (S.D. Cal. 1961), cert. denied 372 U.S. 944 (1963), as in any way holding that, as a general rule of construction, the exceptions set forth in Section 302(c) are to be in all cases strictly and literally construed. This Court, adopting in large part Judge Yankwich's decision in the District Court did of course hold that ". . . *the only* trust funds permitted are those in the six categories now contained within the exceptions." and that ". . . until Congress has spelled out such an intent, with respect to the activities specifically exempted, it is not the function of the courts to create additional exceptions." 310 F.2d at 185-186. So holding this Court struck down as outside of the exceptions, trusts whose asserted purposes included such objectives as "promoting industry betterment and industry public relations, encouraging harmony between labor and management," etc. In our view even a very liberal construction of the exceptions to Section 302 would not have brought such trusts within the exceptions.* Accordingly, it cannot we think be said that this Court was in fact adopting a rule of strict construction to be applied to the meaning of terms contained within the exception. Indeed, application of the rule of strict or liberal construction would have been inappropriate where the mean-

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* The purposes of the trusts here in question are clearly those specified as appropriate in Section 302(c)(5) to wit: medical or hospital care and pension benefits.

ing of the statute was clear without resort to the rules. See *Osaka Shoshen Kaisha Line v. United States,* 300 U.S. 98, 101 (1937); *Ryan v. United States,* 278 F.2d 836, 838 (9th Cir. 1960).

On the other hand, if in the instant case the Court concludes that it is faced with the problem of interpreting the meaning of a statutory provision where the words of the statute do not clearly resolve the issue it will be appropriate for the Court to apply a rule of construction as an aid in reaching a decision. It is our contention that in view of the criminal character of the statute and the nature of the clause in question as constituting an exception, the adoption of a rule of liberal construction would be in order.

C. The Application of a Rule of Liberal Construction in Resolving the Dispute Herein in Favor of Participation of Retired Employees in the Medical-Hospitalization Trust and of Union Employees in Both the Medical-Hospitalization Trust and Pension Trust Would in No Way Defeat Any Purpose of Congress in Enacting Section 302.

A liberal construction in favor of inclusion within the exception would result in a holding that the word "employees" means former employees who have retired and that the words "other employers" includes union employers. Such a liberal construction would in no way defeat any of the purposes of Congress in enacting Section 302.

The broad purposes of Section 302 were aptly stated by Judge Learned Hand in his dissent in *United States v. Ryan,* 225 F.2d 417 (2d Cir. 1955), as follows:

> ". . . Congress wished to prevent employers from tampering with the loyalty of union officials, and disloyal union officials from levying tribute upon employers." (225 F. 2d at 426)

See also *United States v. Toth,* 333 F.2d 450, 453 (2d Cir. 1964); *Sanders v. Birthright,* 172 F. Supp. 895, 901 (S.D. Ind. 1959).

More specifically, insight into the purposes of Congress in enacting Section 302 may be gained from a review of the statements of its proponents immediately after the introduction of the amendment which is now Section 302 and during the course of the Senate debate which followed.

The amendment was introduced by Senator Ball who, at the time, described its purposes as follows:

> ". . . the sole purpose of the amendment is not to prohibit welfare funds, but to make sure that they are legitimate trust funds, used actually for the specified benefits to the employees of the employers who contribute to them, and that they shall not degenerate into bribes . . . ." (93 Cong. Rec. 4804; 2 NLRB, *Legislative History of the Labor Management Relations Act 1947,* p. 1305)

Senator Byrd, who had joined Senator Ball in introducing the Bill and who had been sponsor to an amendment of the so-called "Case Bill" (H.R. 4908) in 1946,

which was substantially identical to the proposed amendment, immediately supplemented Senator Ball's introductory remark, stating as follows:

> ". . . It [the Amendment] has a specific purpose, which is to prohibit the labor unions from requiring welfare funds to be paid into the treasuries of the labor unions. . ." (93 Cong. Rec. 4804; 2 NLRB, *Legislative History of the Labor Management Relations Act 1947*, p. 1305).

On the following day, May 8, 1947, Senator Taft, speaking on behalf of the amendment, went into a more detailed explanation of its provisions.* Explaining the main provision of subsection (5) containing the essential terms here in dispute ("for the sole and exclusive benefit of the employees of such employer and their families and dependents"), Senator Taft said:

> "In other words, this must be a trust fund. It cannot be the property of the union without a definite statement that it is in trust for the employees, who, after all have earned the money." (93 Cong. Rec. 4876; 2 NLRB, *Legislative History of the Labor Management Relations Act 1947*, p. 1311).

Senator Taft commented on subclause (B), which requires that the detailed payment basis on which payments

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* Although Senator Taft was not one of the four Senators who joined in introducing the amendment, he had previously joined Senator Ball and others in urging its introduction and adoption. See: Sen. Rep. 105 on S. 1126, Supplemental Views, p. 52; 1 NLRB, Legislative History of the Labor Management Relations Act 1947, p. 458.

are made is to be "specified in a written agreement with the employer":

> "The purpose of the amendment is to require that the fund shall be established in definite, detailed form, in the form of a trust fund, with respect to which the employees can determine their rights and can insist upon them." (93 Cong. Rec. 4877; 2 NLRB, *Legislative History of the Labor Management Relations Act 1947*, p. 1312).

Concluding his analysis of the amendment, Senator Taft commented upon the purpose of that part of subclause (B) requiring equal representation and provision for the appointment of neutral persons to break deadlocks, as follows:

> "The purpose is to prevent the abuse of welfare funds. . . .
>
> ". . .
>
> ". . . [U]nless we impose some restrictions we shall find that the welfare fund will become merely a war chest for the particular union, and that the employees for whose benefit it is supposed to be established, for certain definite welfare purposes, will have no legal rights and will not receive the kind of benefits to which they are entitled after such deductions from their wages." (Id.)

Finally, immediately prior to the Senate vote adopting the amendment, Senator Ball replied to critics as follows:

> "All that is sought to be done by the amendment is to protect the rights of employees. After all, on any

reasonable basis, payments by an employer to such a fund are in effect compensation to his employees. All that is sought to be done in the amendment is to see to it that the rights of employees in the fund are protected. . . ." (93 Cong. Rec. 4882; 2 NLRB, *Legislative History of the Labor Management Relations Act 1947*, p. 1321)

Thus, the basic purposes of the legislation were to prevent such funds from becoming "war chests" of unions or used by high union officials for their personal gain and to insure that such funds would be used for the direct benefit of employees and their families. Where a bona fide trust, jointly administered as required by Section 302, adequately specifies the types of permissible benefits and the conditions upon which such benefits are to be paid, there is no potential misuse or abuse merely because the term "employee" includes former employees, retired employees, union employees, trust employees or other employees. Similarly, there is no potential abuse or misuse merely because the term "employer" includes a union or the trust itself as well as other employers making contributions at the specified rate. It is submitted that by allowing the union to contribute as an employer would not defeat the congressional purpose of equalizing the representation of the trustees of the trust funds between union representatives and employer representatives because the trusts in question clearly prohibit the union as an employer from having any voice in the selection of the employer trustees. See Record, p. 10 and p. 26. A determination by this Court in accordance with the contentions herein urged will per-

mit the trust funds represented by *amici curiae,* typical of many others throughout the United States, to continue to provide specified benefits to thousands of former employees, retired employees, union employees and trust employees, all of whom are and have been relying on these trusts as a primary source of security.

It is submitted that Congress was not concerned with preventing the kind of conflict of interest between a union and the employees it represents as Judge Bonsal describes in *United States Trucking Corporation v. Strong,* No. 64-3716, ... F. Supp. ..... (S.D. N.Y. March 11, 1965) 58 LRRM 2778, when he states that to permit union employees to participate in trust fund benefits might cause a union to obtain less benefits for the employees it represents so as to pay less contributions for its own employees. Nowhere in the legislative history of Section 302 are there found any statements indicating that preventing such a possible conflict was a purpose of the legislation. It is submitted that such a possible conflict is too remote for Congress to have been concerned with. A union will represent thousands of employees and have very few employees itself. It is unrealistic to believe that a union would demand less benefits to the medical and hospital care and pension plans for the employees it represents in order to hold down the cost of providing such benefits to its own employees. No conflict with the legislative purposes can possibly be found from allowing a union employer to provide its employees with the same benefits obtained for the employees it represents. The only difference here is that to permit the union to contribute to the larger trust plans will allow it to obtain the

same benefits for its employees at a little lower cost than by a private plan.

Moreover, it is submitted that Congress was not intending to prevent employees from receiving medical or hospital care benefits after their employment status had terminated by retirement. Congress was intent on insuring that the funds would directly benefit employees. Certainly employees, whether present or former employees, will be directly benefited if as a result of their employment and contributions made by employers intended for their benefit, they are assured that after retirement, when earnings are reduced, their medical and hospital care expenses, which might greatly increase, will be substantially paid for.

A liberal construction of the words "employees" and "other employers" so as to permit union employees to receive medical-hospitalization and pension benefits from contributions by their union employer and retired employees to receive medical-hospitalization benefits from contributions made by employers for their benefit would in no way defeat any purpose of Congress in enacting Section 302.

CONCLUSION

For the reasons hereinabove stated, the judgment of the District Court should be reversed.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

CHARLES G. BAKALY, JR.

No. 20067

UNITED STATES COURT of APPEALS

FOR THE NINTH CIRCUIT

SUE F. GEORGE, *Appellant*

vs.

NEW YORK LIFE INSURANCE COMPANY, a Mutual Insurance Company, *Appellee*

On Appeal From The United States District Court For The Eastern District Of Washington, Northern Division.

BRIEF OF RESPONDENT

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STATUTES

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BRIEF OF RESPONDENT

I.

APPELLANT'S SPECIFICATIONS OF ERROR

We print as an Appendix to this Brief, for the convenience of this Court, the concise yet complete Opinion of the Trial Court (Tr. 9-14). This consists of seventeen numbered findings.

Appellant excepts to ten of these Findings of Fact. It is worthy of note, however, that appellant does not except to Finding IX or to Finding XVI.

Finding No. IX recites that:

> "There is no evidence that the decedent slipped or fell accidentally."

Finding No. XVI recites:

> "There is no proof of death by external, violent or accidental means."

Bearing in mind that this is a double indemnity policy, that the sum of Fifty Thousand Dollars ($50,000.00) has been voluntarily paid to the appellant on the life provisions of the policy, and that only the double indemnity provision for payment is here in dispute, we call attention to the specific provision of the policy, which provides for payment only:

> "in the event the death of the insured resulted directly from injury effected solely through external, violent and accidental means."

Thus, a finding, unexcepted to, "that there is no proof of death by external, violent or accidental means" would seem to be fatal to this appeal.

Further, we bear in mind the familiar rule on appeal prescribed by 28 U.S.C.A., Rule 52a, which provides:

> "Findings of Fact should not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the Trial Court to judge of the credibility of witnesses."

We remember, too, that this Court has often had occasion to apply this section of the Code of Civil Procedure, saying, only last year, in *Kerr v. C.I.R.*, 326 F. (2d) 225:

> "Findings of Trial Judge will be sustained unless clearly erroneous, or unless not supported by substantial evidence."

Two later cases by this Court applying the same rule are:

Monroe Auto Equip. Co. v. Superior Industries, Inc., 332 F. (2d) 473
Wells-Benz, Inc. v. U.S., 333 F. (2d) 89.

Furthermore, it will be noted that appellant, in her brief, nowhere undertakes the heavy burden of showing that any one of these ten Findings of Fact is "clearly erroneous," or not supported by substantial evidence. Under these circumstances, these Findings of Fact stand as the facts of this case, and conclusively demonstrate that appellant cannot recover.

We have every confidence that each of the Trial Court's findings are supported by a substantial preponderance of the evidence. We refer to these matters merely to lighten the burden of this Court in examining the record.

II.

ADDITIONAL STATEMENT OF THE CASE

Appellant's Statement of the Case, so far as the facts are concerned, consists of a single sentence advising the Court that

> "Henry S. George was found dead on or about, June 24, 1963, in the bath room of a hotel room in Spokane, Washington, where he made his home."

To this should be added the following further facts that negative the claim that appellant's decedent met his death by "external, violent and accidental means."

Decedent's body was found lying crosswise in the bathroom, with his head against the bathroom wall, and his feet resting against the bathtub (R. 18-19). Decedent had a cigarette between the first and second fingers of his right hand (R. 19). This position of the cigarette had not been disturbed by the fall, and it continued to burn after the fall until it accumulated an inch of ash (R. 217, 244), indicating the moveless condition of the body, due to rigor mortis.

There was no foreign material on the floor of the bathroom, and its floor was dry, so that there was no evidence that decedent had slipped or fallen. Unable to offer evidence showing that decedent had slipped, appellant's chief medical witness testified that decedent

". . . was a sick man. He may have been dizzy or fainted. I don't know." (R. 67).

This is as close as appellant was able to come to the cause of decedent's fall. The great preponderance of the evidence is that the decedent died of natural causes, and was dead at or before the time his body hit the floor. (R. 124, 151-2, 161, 180, 215).

Further facts will be set forth in the course of the argument.

III.

ARGUMENT

As we read appellant's brief, we find in it only contentions of fact, two in number: first, the contention that decedent met his death by external violent and accidental means; and second, that appellee failed to show by a preponderance of the evidence that the decedent died from natural causes.

1. Was Decedent's Death Caused by External, Violent and Accidental Means?

For the proof that decedent's death was the result of external, violent and accidental means, appellant relies on just two non-significant circumstances: One, a discoloration or bruise just below the right jaw, the discoloration extending into the lower part of the face that first came into existence the day after decedent's death; and second, a distorted version of an exclama-

tion made by Dr. Kalez immediately on seeing the dead body of decedent in the bathroom when he exclaimed that decedent "could have fallen and broken his neck, or he could have had a stroke or a heart failure." (R. 24)

This off-hand remark about a broken neck, as one of three possibilities, was shown to have no pertinence here since his neck was not broken or injured in any way. Yet, counsel harps on it in his brief to show "violent and accidental means."

As to the discoloration or bruise, at the time of the discovery of the dead body of decedent, Mr. George, the elder brother of decedent, Dr. Kalez, and a little later, the Coroner, all examined the head and upper part of the body quite carefully and discovered no bruise or discoloration at that time. It was only on the day following the discovery of the body when it was at the mortuary, that Mr. George discovered it for the first time. (R. 108). Mr. Hayes, of the mortician staff, described it as a "discoloration," "mottled" and said "it could look like a bruise" (R. 225). He explained its appearance the day afterwards by saying:

> "To us, it looked like the head had been in a position as such and there is where the blood went to." (R. 224-226)

Dr. Kalez gave a similar explanation of this later appearance of discoloration by testifying:

> "It could be just due to pooling of the blood in a portion of the neck post mortem — I mean, after death." (R. 154).

Not only did Mr. George not see this discoloration or bruise on the day of the accident, but the Deputy Coroner, Dr. Higgins, who examined the body carefully within a few hours of its discovery on the 24th of June, after explaining his duty to make such a careful examination, testified as follows:

> "I looked at the patient's head and neck and exposed parts to see if I could see any signs of contusion or lacerations, bruises, hemorrhages, or any sign of external violence, which I could not." (R. 213).

Similarly, Dr. Kalez, one of the first to see the body of the decedent, also made a close examination of the body at that time. He testified that he looked at the face and the jaw, that he would have seen the discoloration "if it would have been sufficient to have been seen," and that there was "no sign of any bruise" (R. 154).

Thus, this attempt of appellant to rely on this so-called "bruise" or this exclamation that the decedent's neck might have been broken when it wasn't — "as evidence of violent and accidental means" simply vanishes into thin air. Therefore, Finding of Fact No. 16, that there is no proof of death by external, violent or accidental means, is fully supported by the uncontradicted testimony.

In support of their contention that Dr. Kalez' exclamation about the possibility of a broken neck and the discoloration of the right jaw that took place at least a full day after the death of the decedent, constituted external, violent and accidental means of the death, appellant cites two Washington cases: The first of these, *Hodgkinson vs. Department of Labor and Industry,* 52 Wash. (2d) 500, 326 P. (2d) 1008, defined the word, "injury" in a Workmen's Compensation case in such general terms as to have no meaning or application here.

The other case is *Hill vs. Great Northern Life Insurance Co.,* 186 Wash. 167, 57 P. (2d) 405, cited merely to quote a statement of the rule in *Horsfall vs. Pacific Mutual Life Ins. Co.,* 32 Wash. 132, 72 Pac. 1028.

But the *Horsfall* case, even if it were applicable here, was overruled in *Evans vs. Metropolitan Life Ins. Co.,* 26 Wash. (2d) 594, 622; 174 P. (2d) 961. In a thirty-five (35) page opinion, the *Evans* case exhaustively reviewed all the earlier cases of the Washington Supreme Court in this field to remove inconsistencies in their earlier cases, achieving this by distinguishing certain of the cases and by directly overruling the *Horsfall* case, as well as *Bennett vs. Mutual Trust Life Ins. Co.,* 21 Wn. (2d) 698; 152 P. (2d) 713. In so distinguishing and overruling certain of its earlier cases, it laid down a rule that, under such a policy as is here involved:

> "It is not sufficient to establish a direct, causal connection between the accident and the injury, but he must show that the resultant condition was caused solely by an accidental means; and if the proof shows a pre-existing infirmity which was a *contributing* factor, he cannot recover." (Emphasis supplied).

As we have heretofore pointed out, Dr. Hill, on whose testimony plaintiff must rely, in answer to an inquiry as to a written statement he had made, describing the cause of death of Henry George, Dr. Hill admitted, "Yes, it [liver disease] would be classified as a contributory disease" (R. 75). A more direct admission, bringing this case clearly within the ambit of the *Evans* case, cannot be immagined.

The *Evans* case has been repeatedly cited by our Supreme Court in approval, and was followed on this point in *Bennett vs. Metropolitan Life Ins. Co.,* 35 Wn. (2d) 284; 212 P. (2d) 790, where it was held:

> "That the evidence left no doubt that the death of the insured was contributed to by his tuberculosis and epileptic condition, as well as injury sustained from a fall, thereby placing the death outside the coverage of the double indemnity clause, and the Trial Court was justified in taking the matter from the jury and dismissing the case." (3rd Syl.)

Even if the discoloration under the jaw had been caused by the fall, the most that could be claimed for the appellant would be that it raised an issue of fact to be determined by the trier of the fact. Since the

Trial Judge determined the fact against appellant, that determination is controlling in this court. There are a number of cases to this effect, but we content ourselves with a quotation from the latest of them which cites the earlier cases.

In *Davis vs. North American Accident Ins. Co.,* 39 Wn. (2d), 145, 146; 234 P. (2d) 871, the Supreme Court of Washington said:

> "Normally it is most difficult to determine precisely or even to estimate the contribution of preexisting disease to an injury where the latter appears prima facie to have been the result of an accident. The question then presented is a purely factual one. Where there is conflicting evidence, the problem should be resolved by the trier of the facts. *Graham vs. Police and Firemens Ins. Assn.,* 10 Wn. (2d) 288; 116 P. (2d) 352; *Towey vs. N. Y. Life Ins. Co.,* 27 Wn. (2d) 829; 180 (2d) 815. See, also, *Bennett vs. Metropolitan Life Ins. Co.,* 35 Wn. (2d) 284; 212 P. (2d) 790."

2. Did Decedent Die of Natural Causes?

Appellant's second contention, based on the false assumption that appellant had made a prima facie case of death by violent and accidental means, which shifted the burden of proof to the appellee, consists of a statement that:

> "There is a complete failure to establish, by a preponderance of the evidence, that the deceased died of natural causes."

While the foregoing demonstrates that there was no such burden resting on appellee, the record does clearly disclose, by an overwhelming preponderance of the evidence, that the decedent did die of natural causes. The four physicians who unequivocally testied that in their judgment he died of natural causes, are nowhere contradicted on this point, save by a half hearted hypothesis of Dr. Hill, to be later discussed.

Dr. Kalez, who had treated the decedent as his physician for many years (R. 114-121), and who was first to be present when decedent's death was discovered, testified that "my conclusion was he died of natural causes." (R. 123); "death may occur from his natural causes suddenly and unexplainably without any minute findings" (R. 149).

On cross-examination by appellant's counsel, he gave the following further testimony:

> "Q. ***Wouldn't you conclude * that it is just as possible he slipped and fell and hurt himself and died as a result of that?
>
> "A. No, because the preponderance of the evidence is on the other side.
>
> "Q. *The cigarette,* right?
>
> "A. The *cigarette* — no evidence of external injury, sudden, acute rigor mortis ** the preponderance of opinion of both myself and the Coroner was that it was a natural death in view of the fact that there was nothing to substantiate any other cause." (R. 151-152).

Dr. Myhre, the second medical expert called by appellee, likewise testified unequivocally that "it was a natural death." (R. 161) He was followed by Dr. Stier, who gave exactly the same testimony (R. 180). Dr. Higgins, the Deputy Coroner, also testified that "My opinion was that it was a natural death." (R. 215).

Faintly opposed to this positive, unqualified testimony of these four physicians, there is only the uncertain, inconclusive testimony of Dr. Hill.

On cross-examination, Dr. Hill gave the following testimony:

> "Q. You came to the conclusion that you would have to speculate as to what was the cause of his death?
>
> "A. I would.
>
> "Q. And you certainly have expressed no opinion as to what caused it: if he fell, what caused the fall?
>
> "A. The only opinion I could possibly express there is that he might have fainted from his liver disease or something of that nature, but this is speculation." (R. 69)

Dr. Hill was appellant's only witness as to the cause of decedent's death. Of appellant's two other medical witnesses, Dr. Logan merely testified on the question of hypoglycemic shock, due to the fatty metamorphosis of decedent's liver, resulting from his

heavy drinking, and Dr. Kleaveland testified only in contradiction of Dr. Myhre's conclusion that the decedent's death was due to ventricular fillibration. Neither of them ventured any opinion as to the cause of the death of the decedent.

A clear distinction exists between this admittedly speculative opinion of Dr. Hill and the positive, unequivocal testimony of the four physicians mentioned above that the decedent's death was due to natural causes.

These several opinions of the four doctors that the death of the decedent was due to natural causes, that he was dead before his body struck the floor, were in no sense speculative. They were based on physical facts, i.e., the head in a cramped position when, if the decedent had been alive, as even Dr. Hill has admitted, the decedent would and easily could have struggled into a position readily permitting breathing (R. 69), the cigarette held in his hand, so moveless that it burned down to the filter with an inch of ash, wholly undisturbed by even the slightest movement in the hand (R. 196, 244-5); the fact that he fell crosswise in the bathroom when, if he had slipped as he entered the bathroom, he would have fallen forward or backward; the complete absence of any condition of the floor that could have caused the fall, etc. These were opinions based on observed physical facts, and there were no physical facts that in any way contradicted them.

The fall of decedent, sidewise, the narrow way of the bathroom, is highly significant as explained by Doctors Myhre and Stier. Dr. Myhre testified as follows:

> "Q. What is the natural reaction of the body when somebody dies suddenly like that? * * * (R. 17)
>
> "A. *** pitched forwards, backwards, sideways."
>
> "Q. Any way?
>
> "A. Any way."

And Dr. Stier, questioned on the same point, testified:

> "A. The body would fall in whatever position the death occurred." (R. 182)

This testimony not only explains the fall sidewise, but confirms the judgment of the physicians that the decedent was suddenly stricken and dead before the body reached the floor.

This conclusion that the decedent died of natural causes is further fortified by the physical condition of the decedent, suffering as he was from "a very marked and severe fatty change in the liver" (R. 59), "due to excessive drinking" (R. 73), as testified to by Dr. Hill.

Coupled with this was his abnormally high blood pressure (R. 115), as testified to by Dr. Kalez, his physician for the last eight years of his life (R. 114). In this eight-year period, the decedent's blood pressure in 1959 was 208/98 and 198/86 (R. 116); in 1961, it was 220/120 (R. 114) and in 1963, it was 224/128-32 (R. 118). This high blood pressure, like the fatty metamorphosis of the liver, was attributed to his heavy drinking (R. 120). Dr. Kalez further testified that high blood pressure "is in itself a disease" (R. 120) called "hypertension." These facts taken in consideration with the external, physical facts and the opinions of five of the six physicians testifying as to the cause of death, fully justified the Trial Court in finding (F of F No. 14):

> "The only unrefuted cause of death was from natural causes, i.e., a cerebral vascular accident."

True, there was a divergence of opinion among the physicians as to the particular disease that caused the death of decedent. But these opinions as to the particular disease are only secondary and derivative from the fact that he died of natural causes.

On this subject as to when testimony as to the cause of death or injury is speculative, in an often cited case, *Frescoln v. Puget Sound T. Co.,* (90 Wash. 59, 63; 155 Pac. 395), Judge Chadwick gave an opinion as to what many times has been accepted by the Supreme Court of Washington as a sound definition of such speculation when he wrote:

> "Speculation and conjecture, when used in this connection mean the same thing. The cause of an accident may be said to be speculative when, from a consideration of all the facts, it is as likely that it happened from one cause as another."

Judged by this test, the unanimous opinion of these physicians, based on these physical facts and ratified by the opinion of the Trial Judge, can in no sense be said to be speculative or conjectural. The only conjectural testimony on this point is that of Dr. Hill, who admitted frankly that he had to speculate as to the cause of the fall of the decedent. (R. 69).

Inasmuch as plaintiff's case rests entirely on the testimony of Dr. Hill, a more extended analysis of his testimony is in order.

Dr. Hill's strongest statement as to the cause of the death of decedent was given on direct, as follows:

> "It seems to me that it is more logical to assume that the death had actually been due to the obstruction of the airway." (R. 62)

However, on cross-examination, Dr. Hill whittled away this statement until practically nothing is left of it by the following admissions:

> "Q. Actually, you found no anatomical findings to indicate asphyxiation?
>
> "A. That is true, sir**"

"Q. Also, isn't it true, sir, that in the majority of cases you do find cyanosis?

"A. In the great number of them, you do, no question about it.

"Q. Actually, when it comes down to it, the only basis of your conclusion that there may have been asphyxation was the position of the body as described to you?

"A. Yes, in the absence of any visual findings that I could see that would cause the death.

"Q. Actually, in the great majority of the cases of asphyxation, there are convulsions, too, are there not?* * *

"A. In the great majority of them, yes." (R. 73, 74).

Continuing the cross-examination:

"Q. During this period of time, if the body were in a very awkward, uncomfortable strained position, the body would just naturally reflex itself out of it?

"A. There would certainly be an attempt to get up, I would think, at least if he is conscious.

"Q. I will ask you if you don't recall, on the 24th day of December, 1963 * *, if then at that time you didn't in your own handwriting state to him that in your opinion that liver disease was contributory to the death of Henry George?

"A. Yes, it would be classified as a contributory disease." (R. 74, 75).

Having in mind the provision of the policy that it only comes into effect "in the event the death of the insured resulted directly from injuries effected *solely* through external, violent and accidental means," this admission of Dr. Hill that his liver disease contributed to his death, is of itself fatal to the contention of the plaintiff, as we shall see when we examine the authorities on this point.

After these several admissions of Dr. Hill that the liver disease of the decedent was contributory to the death of Henry George (R. 75); that if his head were in such a position to cut off his breathing, there would "*certainly*" be an effort to rise from it or "reflex out of it," the only basis of his opinion that the death was due to the obstruction of the airway, was the awkward, strained position of the head.

What is left of Dr. Hill's assumption that death had been due to the obstruction of the airway of the decedent? What he has expressed — not as an opinion, but a mere assumption — is thoroughly contradicted and annulled by these later admissions of want of physical evidence to support the assumption.

Even so, Dr. Hill's tenuous assumption is overborne by the opinions of five other doctors on this point as to strangulation. Dr. Stier, being asked if it were possible for the decedent to have his wind-pipe cut off in that position replied:

> "I believe it would have been a remote possibility. I have not ever in my experience or reading found or heard of a case where strangulation occurred in such a position." (R. 185).

Dr. Myhre, being asked the same question, was even more emphatic:

> "I know of no conceivable way the neck can be extended or flexed and cut off an airway without fracturing or breaking the neck." (R. 164).

In response to a similar question on cross-examination, Dr. Kalez testified:

> "It would be almost impossible in a husky bull-necked fellow like that. If he had, he would have had convulsions prior to his death." (R. 145).

Dr. Higgins, the Deputy Coroner, in a much more extended exposition of his view, reached the same conclusion as Drs. Stier, Myhre and Kalez (R. 217-218), while Dr. Hubbard joined his four colleagues in testifying that the death of the decedent was not due to strangulation (R. 208-209).

This massive array of expert medical opinion completely overwhelms whatever was left of Dr. Hill's highly qualified assumption that the decedent's death was due to the "obstruction of the airways" (R. 64) and leaves no evidence on which appellant can rely that defendant's death was in any way due to violent or accidental means.

3. Appellant's Major Legal Contention

Under the heading of "Legal Issues and Authorities," on Pages 12-17 of Appellant's Brief, beginning with *Graham vs. New York Life Insurance Company,* 182 Wash. 612, 47 P. (2d) 1029, and ending with *Doke vs. United Pacific Ins. Co.,* 15 Wn. (2d) 536, 131 P. (2d) 436, great and quite unnecessary efforts are made by appellant to establish the rule that, once a prima facie case of death solely by external, violent and accidental means has been made by the plaintiff, the burden of proof then reverts to the defendants. But that is precisely the rule adopted by the Trial Court in this case. After noting that the law of Washington controls and is well established, and that there is no basic dispute between the parties as to the law, the Trial Judge wrote:

> "Where a claim is made by the beneficiary and rejected by the insurer on a double indemnity coverage such as is before us, the plaintiff has the burden initially of proving that the insured's death was caused by violent, external and accidental means. Upon a prima facie showing by the defendant in this regard, the burden shifts to the defendant to overcome the proof of death by violent, external and accidental means, or to prove the bar of some other exclusion under the policy." (Appendix A, this Brief).

There are just two vital reasons why these cases of appellant have no relevance. In the first place, appellant failed to prove that the insured's death was caused by violent, external and accidental means; and

in the second place, the appellee proved by an overwhelming preponderance of the evidence that the decedent died from natural causes.

4. Admissibility of Peter Dix's Opinion

On Pages 17-20 of Appellant's Brief, appellant urged that the Trial Court erroneously refused to admit the opinion of Peter Dix, a layman, as to "what happened to him (the decedent) at that time," *Graham v. Police and Firemen's Assn.*, 10 Wn. (2d) 288, 116 P. (2d) 352, and *Arthurs v. National Postal Trns. Assn.*, 49 Wn. (2d) 570, 304 P. (2d) 685, are cited in support of the right of the appellant to use this opinion of Peter Dix.

But these cases only support the admission of "information" when such "information is the result of *familiar association.*" Then, only, "the layman may testify to disposition, appearance and physical condition of an individual." But Peter Dix has already testified at considerable length; (R. 14-22) as to the disposition, appearance and physical condition of the decedent. His layman's opinion that was sought is indicated by the offer of proof (R. 23) that "it was his opinion that he had fallen * * * and:

> "was jammed in the bathroom in that position, and that his neck appeared to have been out of place or broke, and that he would suffocate because he could not breathe."

Here, there was plainly offered an invasion by a layman in the field of opinion that can only be given by an expert. His surmise that the neck was broken is, of course, altogether erroneous, and his opinion that decedent had suffocated had nothing to go on but the observation of the position of the body which he had given in full detail. Under these circumstances, the following cases and others that could readily be cited to the same effect would seem to be conclusive against the admission of such opinion:

In *Almanza vs. Phelps-Dodge Corp.,* 57 Ariz. 150 112 Pac. (2d) 215, it was held:

> "On the question whether disability resulted from injury rather than disease, medical testimony only is admissible."

Similarly, in *Griesel v. Fabian,* 184 Okla. 42, 84 Pac. (2d) 634, the rule was stated:

> "Where an injury is of such a character as to require skilled and professional men to determine the cause thereof, the question is one of science which must be proved by skilled and professional men."

See also *Cohenour v. Smart,* 205 Okla 668, 240 Pac. (2d) 91, 94.

Indeed, the Supreme Court of Washington said in *Orcutt v. Spokane County,* 58 Wn. (2d) 846, 364 P. (2d) 1102, at Page 853:

> "Medical testimony is *necessary* when the causal relationship is not clearly disclosed by substantial evidence." (Emphasis supplied.)

In any event, in the present case, the ruling on the offer of proof had no significant effect upon the outcome; for the fact is that, notwithstanding the court's ruling, the plaintiff succeeded by other questions in getting into the record the facts contained in his offer of proof. First, Mr. Dix's opinion that the decedent's neck "appeared to be dislocated or broken." (R. 20) and secondly, his opinion that the decedent's position was such that he could not breathe. (R. 20-21).

Furthermore, this proffered opinion of an untrained observer was wholly immaterial. In view of the massive expert testimony that decedent did not die of suffocation, and the medical reasons why suffocation could not take place, it is inconceivable that the Trial Court would or could have given any credence to this off-hand impression of Mr. Dix.

IV.

CONCLUSION

In closing we summarize:

Since no more has been shown in this case concerning the cause of death other than the finding of the dead body of decedent in his hotel bathroom, since there is no evidence that the decedent slippd or fell ac-

eidentally; since there is no evidence that the decedent met his death by external, violent or accidental means; since, on the contrary, the overwhelming conclusion of the expert medical testimony is that decedent met his death through natural causes; and since, finally, the Trial Court's findings, based on the preponderance of the evidence, fully sustains the foregoing summary of the evidence, it follows, we respectfully submit, that the judgment of the Trial Court should be affirmed.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

Benjamin H. Kizer, one of the attorneys for the respondent states:

I certify that, in connection with the preparation of the within brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with these rules.

Benjamin H Kizer

Attorney for Respondent

APPENDIX

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION

SUE F. GEORGE,
Plaintiff,
vs.
NEW YORK LIFE INSURANCE COMPANY, a Mutual Insurance Company,
Defendant.

NO. 2513

MEMORANDUM OPINION

This matter is before the court for determination on the merits following a trial to the court without a jury. Plaintiff appeared at said trial on November 19, 1964, represented by her attorneys, William B. Bantz and Michael Hemovich; defendant appeared by and through its attorneys, Benjamin H. Kizer and Robert E. Stoeve. Evidence was received, arguments and briefs have been submitted and the cause is fully presented.

The defendant, Henry S. George, was found dead, on or about June 24, 1963. in the bathroom of the hotel room in Spokane, Washington, where he made his home. At the time of his death there was in full force

and effect a life insurance policy on the life of the said Henry S. George, written by the defendant company. By the terms of said policy the plaintiff was beneficiary. The life policy was in the face of $50,000.00 with a so-called double indemnity rider calling for payment of an additional $50,000.00 to the beneficiary in the event the death of the insured "resulted directly, and independently of all other causes, from bodily injury effected solely through external, violent and accidental means . . . ".

It is undisputed that timely proof of death and proper claims for both the basic and the double indemnity coverage were made. The face amount of the policy, $50,000.00, was paid and the defendant refused payment of the accidental means death provision of the policy.

As it is shown in the pretrial order, duly entered in the cause, the issue presented by the contentions of the parties resolves down to the question of whether or not the insured died by external, violent and accidental means within the language of the insurance policy in question.

The Law of the State of Washington controls and appears well established. Actually there is no basic dispute between the parties as to the principles of law applicable to the sole issue presented in this cause. Where a claim is made by the beneficiary and rejected by the insurer on a double indemnity coverage such

as is before us, the plaintiff has the burden initially of proving that the insured's death was caused by violent, external and accidental means. Upon a prima facie showing by the plaintiff in this regard, the burden shifts to the defendant to overcome the proof of death by violent, external and accidental means or to prove the bar of some other exclusion under the policy.

The issue being narrowed and the applicable law clearly established, the relevant facts as established by the proof need to be stated:

The court finds from the evidence that the following facts have been proved:

(1) That the decedent's body was found from twelve to thirty hours after death in a cramped position in a bathroom; the body was in a state of extreme rigor mortis.

(2) There were no external marks of bruises or contusions of any kind indicating an injury. Some evidence of a blueness below the right jaw line was offered, but this was post mortem lividity and not a bruise.

(3) That a cigarette, burned to the filter or to the skin line, was discovered in the right hand of the corpse with an ash in place of a length slightly over an inch. It was stipulated that such ash would result

from a burning of the cigarette for a period of four to five minutes.

(4) Upon examination by physicians, the body showed no evidence of petechial hemorrhaging; no evidence of cyanosis and no evidence that convulsions had preceded death. No injury to the air passages was found. Some or all of these conditions are present in the majority of cases where there has been death by strangulation.

(5) An autopsy was performed on the cadaver some four days after the body was discovered, which was nearly five days after death. No anatomical cause of death could be ascertained by the pathologist performing the autopsy.

(6) The decedent had a history of high blood pressure, indicating the disease of hypertension. A common cause of death in hypertension cases is by circulatory vascular accident, that is, a rupture of a blood vessel.

(7) Because of the elapsed time between the death and the autopsy, post mortem autolysis had set in and the cells of the brain were so deteriorated as to cause microscopic examination of the brain cells to be valueless.

(8) The liver was the only bodily organ showing any significant pre-death malfunction. This organ

showed a marked, severe and diffuse fatty metamorphosis, probably due to longtime over-indulgence in alcohol by the decedent. In this disease, fatty substance infiltrates the liver cells and reduces the ability of the liver to store sugar needed to maintain the sugar level in the blood.

(9) There is no evidence that the decedent slipped or fell accidentally.

(10) A total of eight doctors testified to a total of four different possible causes of death; strangulation, hypoglycemic shock; cerebral vascular accident (stroke); and ventricular fibrillation. Each of such doctors admitted that the conclusion reached by him was the result of speculation. Insufficient physical evidence of the cause of death could be demonstrated by any doctor or doctors to establish with certainty the exact reason for the death of the insured decedent.

(11) The opinion of Dr. Hill, pathologist and principal medical witness for the plaintiff, that death was by strangulation, was based on a description of the position of the body given to him by Doctors Kalez and Higgins, each of whom viewed the body prior to its being moved. However, these two doctors, who viewed the body, stated that the air passages were not closed by the position of the body. In view of this fact, and the absence of any of the usual conditions present with strangulation deaths, Dr. Hill's conclusion of

strangulation is not based on a satisfactory premise and cannot be accepted.

(12) The deceased had eaten a meal shortly before death which was partially digested. This fact excludes the diagnosis of death by hypoglycemic shock and such diagnosis is unacceptable.

(13) Death, having its primary cause from ventricular fibrillation, under the proof, is purely a theoretical conjecture and the court discounts it.

(14) The only unrefuted cause of death was from natural causes, i. e., a cerebral vascular accident.

(15) The court finds that Henry S. George was dead or dying while still on his feet and in an erect position.

(16) There is no proof of death by external, violent or accidental means.

(17) The condition of the liver of the decedent did not substantially contribute to death.

The court concludes from the foregoing facts that the plaintiff has failed, initially, to prove that the insured died from violent, external and accidental means.

Further, the court concludes that the defendant has proved by a preponderance of the evidence that death

vas not caused by violent, external and accidental neans, and that, on the contrary, death was by natural auses.

The defendant must therefore prevail and the court o determines. Plaintif's complaint is to be dismissed nd judgment is to be for the defendant with its costs.

This memorandum opinion embodies the court's indings of fact and conclusions of law under Rule 52, 'ederal Rules of Civil Procedure. Either party may ubmit requests for other or more detailed findings s provided in said Rule.

The attorneys for the defendant will prepare and ubmit a judgment in accordance herewith.

DATED: December 7, 1964.

Ray McNichols
District Judge.

No. 20067

UNITED STATES COURT of APPEALS

FOR THE NINTH CIRCUIT

SUE F. GEORGE, *Appellant,*

vs.

NEW YORK LIFE INSURANCE COMPANY, a Mutual Insurance Company, *Appellee.*

On Appeal From The United States District Court For The Eastern District Of Washington Northern Division

---

BRIEF OF APPELLANT

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NATIONAL PRINTING CO.

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BRIEF OF APPELLANT

JURISDICTIONAL STATEMENT

This case is based upon a Washington State Resident's suing a foreign corporation for a sum in excess of ten thousand dollars ($10,000.00). 28 USCA 1332 (R-2-3) and pretrial order.

The case was tried before the United States District

Court, Eastern District of Washington, Northern Division, without a jury on November 19, 1964. Judgment was entered for the defendant on the 21st day of December, 1964. Appeal is being taken from said judgment.

STATEMENT OF THE CASE

The decedent, Henry S. George, was found dead, on or about June 24, 1963, in the bathroom of a hotel room in Spokane, Washington, where he made his home. At the time of his death there was in full force and effect a life insurance policy on the life of the said Henry S. George, written by the defendant company. By the terms of said policy the plaintiff was beneficiary. The life policy was in the face amount of $50,000.00 with a double indemnity rider calling for payment of an additional $50,000.00 to the beneficiary in the event the death of the insured "resulted directly, and independently of all other causes, from bodily injury effected solely through external, violent and accidental means. . . ."

It is undisputed that timely proofs of death and proper claims for both the basic and the double indemnity coverage were made. The face amount of the policy, $50,000.00, was paid and the defendant refused payment of the accidental means death provision of the policy (Pre-Trial Order).

As is shown in the pretrial order, the issue presented by the contentions of the parties resolves down to the question of whether or not the insured died by

external, violent and accidental means within the language of the insurance policy in question.

The law of the State of Washington controls. Actually there is no basic dispute between the parties as to the principles of law applicable to the sole issue presented in this cause. Where a claim is made by the beneficiary and rejected by the insurer on a double indemnity coverage such as is before us, the plaintiff has the burden initially of proving that the insured's death was caused by violent, external and accidental means. Upon a prima facie showing by the plaintiff in this regard, the burden shifts to the defendant to overcome the proof of death by violent, external and accidental means or to prove the bar of some other exclusion under the policy.

SPECIFICATIONS OF ERROR

The court erred in the following paragraphs set forth in the Court's Memorandum dated December 7, 1964, which was used as the Findings of Fact and Conclusions of Law pursuant to Rule 52.

(2) There were no external marks of bruises or contusions of any kind indicating an injury. Some evidence of a blueness below the right jaw line was offered, but this was post mortem lividity and not a bruise.

This finding is not sustained (R65-66 and 241).

(4) Upon examination by physicians, the body showed no evidence of petechial hemorrhaging; no

evidence of cyanosis and no evidence that convulsions had preceded death. No injury to the air passages was found. Some or all of these conditions are present in the majority of cases where there has been death by strangulation.

This finding was refuted by Dr. Hill (R-64-65-66).

(5) An autopsy was performed on the cadaver some four days after the body was discovered, which was nearly five days after death. No anatomical cause of death could be ascertained by the pathologist performing the autopsy.

This finding was explained by Dr. Hill (R-60) and if finding is correct it would appear to eliminate death by cerebral vascular accident as found by the court, as Dr. Hill stated he would have found such if it were the case.

(6) The decedent had a history of high blood pressure, indicating the disease of hypertension. A common cause of death in hypertension cases is by circulatory vascular accident, that is, a rupture of a blood vessel.

There was no testimony that it caused his death or that he had any real problem with high blood pressure at time of his death and it did not show in the autopsy. Hill (R-60), Stier (R-187), Kalez (R-137).

(7) Because of the elapsed time between the death and the autopsy, post mortem autolysis had set in and the cells of the brain were so deteriorated as to cause microscopic examination of the brain cells to be valueless.

Dr. Hill refutes this and states he could tell, and would have made necessary findings if deceased had a stroke that would have killed deceased (R-60).

(8) The liver was the only bodily organ showing any significant pre-death malfunction. This organ showed a marked, severe and diffuse fatty metamorphis, probably due to longtime over-indulgence in alcohol by the decedent. In this disease, fatty substance infiltrates the liver cells and reduces the ability of the liver to store sugar needed to maintain the sugar level in the blood.

Three doctors found that this was not a contributing factor to his death. Dr. Logan (R-81), Dr. Higgins (R-219), Dr. Kleveland (R-232).

(10) A total of eight doctors testified to a total of four different possible causes of death: Strangulation, hypoglycemic shock; cerebral vascular accident (stroke); and ventricular fibrillation. Each of such doctors admitted that the conclusion reached by him was the result of speculation. Insufficient physical evidence of the cause of death could be demonstrated by any doctor or doctors to establish with certainty the exact reason for the death of the insured decedent.

The only doctor using facts that he saw and further, that stated, after knowing the facts "more likely than not what he died from was strangulation," was Dr. Hill (R-61).

(11) The opinion of Dr. Hill, pathologist and principal medical witness for the plaintiff, that death was

by strangulation, was based on a description of the position of the body given to him by Doctors Kalez and Higgins, each of whom viewed the body prior to its being moved. However, these two doctors, who so viewed the body, stated that the air passages were not closed by the position of the body. In view of this fact, and the absence of any of the usual conditions present with strangulation deaths, Dr. Hill's conclusion of strangulation is not based on a satisfactory premise and cannot be accepted.

Dr. Hill was allowed only to take Kalez and Higgins' word for how he looked. Court refused to let Peter Dix testify and offer of proof was made as to the testimony which should have been admitted (R-23). Furthermore, we find nothing in record to substantiate the Court that Dr. Higgins stated "air passages were not closed when he viewed the body," and further, Dr. Kalez (R-125) states as follows:

> "Q. Assuming there was no obstruction of the windpipe due to food or any foreign object, I will ask you, sir, if the position in which that body was lying was such that if the person had not been dead, could he have breathed?
>
> "A. Well, it would be speculative but I think that he could have due to his build in the neck; however, we were suspicious that he might have hit his head or might have even broken his neck on the fall, but if he had it would have occurred after death and that is why we asked for the autopsy."

(14) The only unrefuted cause of death was from natural causes, i.e., a cerebral vascular accident.

This was controverted by Dr. Hill (R-60), Dr. Stier (R-187), Dr. Kalez (R-137).

(15) The court finds that Henry S. George was dead or dying while still on his feet and in an erect position.

No evidence to this—only speculation of some doctors, but was controverted by Dr. Hill.

The Court concludes from the foregoing facts that the plaintiff has failed initially to prove that the insured died from violent, external and accidental means.

The Court found that there was enough evidence at the end of plaintiff's case to deny the defendant's motion for dismissal of the action (R-112).

At this time, the burden shifted to the defendant as to cause of death. The defendant then came up with three separate causes of death and each of the three doctors for the defendant said that the other doctors' diagnosis was wrong and did not agree with it.

The Court then concluded that the defendant had proved by a preponderance of the evidence that death was not caused by violent, external and accidental means, and that, on the contrary, death was by natural causes.

Again, how can the court find a preponderance of evidence from the defendant's witnesses when the defendant shows three causes of death, all not connected with the other, all disagreeing with the others'

reasons and specifically, the defendant's pathologist, Dr. Stier, disagrees with Dr. Kalez as to the cause of death and yet the Court finds that Dr. Kalez is apparently correct. Then the defendant's Dr. Myhre disagrees with both of them. Dr. Higgins took Dr. Kalez' word for cause of death; however, even Dr. Higgins disagreed with the defendant's other doctors as to the liver, heart and fibrillation contributing to or causing deceased's death.

EVIDENCE

The evidence shows that Dr. John Hill did the autopsy on the deceased (R-47-48) on June 28, 1964. It further shows that Dr. Hill is the pathologist at one of the largest hospitals in the northwest and that he has done over seven thousand autopsies (R-47).

The evidence showed that Dr. Hill was the only doctor that testified that had actually thoroughly examined the deceased except for the embalmer, Bill Hayes (R-222 & 229).

The evidence showed that Dr. Hill, as pathologist doing the autopsy, was in the best position to know what happened. The defendant's own witness, Dr. Stier, another pathologist, so stated (R-199).

The evidence did show by Dr. Hill that there was no anatomical reason for death, but that after knowing all the facts and now knowing the position the deceased was found, he stated: "That it was more likely

than not that he would strangle or suffocate in the position he was found." (R-61).

Dr. Hill testified further that he did not die because of a *heart attack, a stroke,* or *liver disease.*

Dr. Stier agreed with Dr. Hill as to death by heart attack or stroke or other circulatory diseases (R-187).

Dr. Logan, a liver specialist, agreed with Dr. Hill as to the liver disease not being fatal (R-81).

Dr. Higgins also agreed that the liver did not kill him nor did hypoglecemic shock (R-219 & 220).

Dr. Kleveland agreed with Dr. Hill that his heart through ventricular fibrillation did not kill deceased nor was there any relationship between the liver and ventricular fibrillation (R-232).

Dr. Myhre stated that deceased died of ventricular fibrillation, however, no one else agreed with this diagnosis.

ARGUMENT

The trial court, sitting without the jury, at the end of the plaintiff's case apparently felt that there was sufficient evidence to not grant the motion dismissing this action. The court felt, at that time, that the plaintiff proved by a prima facie case that the deceased died from bodily injuries effected solely through external, violent and accidental means which would allow the plaintiff to recover.

At the time the motion to dismiss was denied, the

burden shifted to the defendant for them to show that the deceased did not die from bodily injury effected solely through external, violent and accidental means. All the defendant proved was simply a fact that their doctors, namely five as set forth in the record, could not agree on any one cause of death—in fact, the defendant's doctors specifically set forth three distinct and separate causes of the death and while doing so, each of the defendant's doctors contradicted the other defendant's doctors. The defendant, by this type of testimony does not show by a preponderance of the evidence that the deceased died of natural causes. All they do is show that five doctors do not agree, in fact disagree, with one another why the deceased died. All of the defendant's doctors admitted that they were speculating and that they did not know the cause of death with any reasonable medical certainty.

In substance, all the defendant did was to say to the court, we do not know, you take your choice. Dr. Hill, the plaintiff's doctor, was the only doctor that examined and did an autopsy on the deceased and was the only one that could determine any real medical facts, and he stated that "after knowing all of the facts, that it was more probable than not that the deceased died of strangulation or suffocation." (R-61).

Once the burden shifted to the defendant and they failed to sustain the burden of proof by a preponderance of the evidence, the verdict should have been for the plaintiff.

The court relied on inconsistent testimony of the

defendant's own witnesses in determining the cause of death. The court set out in its finding number 14, "The only unrefuted cause of death was from natural causes, i.e., a cerebral vascular accident"; however, this was refuted not only by Dr. Hill (R-60) but defendant's own Dr. Stier (R-187) and Dr. Kalez (R-137).

There is not sufficient evidence in the record for the court to find that there was a preponderance of evidence that the deceased died of natural causes. The court could and did only speculate as to the cause of death from the evidence as there was no substantial evidence of this—only conjecture and speculation.

Washington Supreme Court has repudiated the so called scintilla of evidence rule and has repeatedly held that evidence sufficient to support a verdict must be substantial.

There was more than sufficient evidence to properly cover the wounds or injury aspect of the case. There was testimony by doctors as well as laymen that it looked like the deceased had a broken neck. There was a bruise and swelling on lower right jaw and on the right side of neck.

The plaintiff should have been allowed to have Peter Dix' testimony admitted as a layman's viewpoint of whether or not the deceased would have been able to breathe.

The real expert in the case was Dr. Hill. The record shows he has done over 7,000 autopsies; that he is the head pathologist of one of the largest hospitals in the Northwest. He was the only one in the position to

properly evaluate the cause of death. As was stated before, even the defendant's pathologist, Dr. Stier, said Dr. Hill was the one in the best position to know what went on. The other doctors were only trying to second guess Dr. Hill at the time of trial and their findings were strictly based on conjecture and speculation.

The specification of errors set out previously by number in the judge's memorandum opinion, and the answers set out to each specification of error shows that the court did not take into consideration all of the testimony of the doctors. The assignments of error are well taken in that the memorandum opinion used by the court and the defendant for its findings and conclusions was in error and the verdict should have been granted for the plaintiff.

LEGAL ISSUES AND AUTHORITIES

Burden of Proof:

Once the plaintiff has made a prima facie case that the deceased died under the accidental provision of the life policy, the burden of proof then shifts to the defendant and the defendant must prove by a preponderance of the evidence that the deceased died from natural causes and that this burden of proof cannot be sustained or upheld by a mere matter of conjecture or speculation.

In *Graham v. New York Life Insurance Company,* 182 Wash. 612 at page 619:

> "In an action for a double indemnity under an accident clause where an insured fell or jumped from a fire escape at the 16th floor of a building, the presumption of accidental death from a death by external and violent means remains and was not overcome, or the affirmative defense of suicide established, where all of the facts and circumstances tending to support the defense were subject to different constructions."

As was stated in the case of *Browning v. Equitable Life Assurance Company,* 80 P. (2d) 348, the Court laid down the rule that the burden of going forward with the proof is on the insurer to establish that the injury or death came within the exclusion clause of a particular policy.

The case of *Griffin v. Prudential Insurance Company,* 133 P. (2d) 333, (Utah), sets forth the same proposition, that is, that where the insurance company relies on an exclusion or exception clause contained in the policy, the burden of proof is on the insurer; in an action for double indemnity in a case where death results from a fall, the cause of which is unknown, to show that the fall resulted "directly or indirectly from bodily or mental infirmity or disease in any form.

Trotter v. Industrial Health, Accident & Life Insurance Company, 175 Atl. 884, (Penn.) the Court held that the insurer had burden in proving the defense that the insured died of heart disease within the exception in the policy. To the same effect is the case of *Nalty v. Federal Casualty Company,* 245 Ill. App. 180.

In *Metropolitan Life Insurance Company v. Broyer,*

20 F. (2d) 818, where the plaintiff brought forward evidence that death occurred in such a way as naturally pointed to accident, plaintiff was held not bound to disprove negatively other causes of death.

Rogers v. Prudential Insurance Company of America, 270 Ill. App. 515, the Court held that where a plaintiff in an action on insurance policies providing for double indemnity in case of accidental death makes out a prima facie case of death of the insured from external, violent and accidental means, the burden is then upon the defendant to show that the death resulted from a cause excepted in the policy.

As is pointed out in the case of *Metropolitan Life Insurance Company v. Jenkins,* 12 So. (2d) 374, the defendant insurance company cannot meet its burden of proof by speculation, conjecture and surmise, but must find some logical support in the testimony to sufficiently establish its defense.

Continental Casualty Company v. James Paul, 209 Ala. 166, 95 So. 814, 30 A. L. R. 802 (1923).

> "We recognize, of course, that what is referred to as the scintilla doctrine prevails in this state, but this does not at all conflict with the equally well-known rule that a conclusion as to liability which rests upon speculation pure and simple is not the proper basis for a verdict. 'Inference in legal parlance, as respects evidence, is a very different matter from 'supposition.' The former is a dedication from proven facts; while the latter requires no such premise for its justification. And the courts and juries in dealing with the inquiry whether a party has discharged his burden of

> proof, cannot pronounce upon mere supposition that the burden has been met.' . . . Where testimony leaves the matter uncertain, and shows that any one of half a dozen things may have brought about the injury, for some of which the employer is responsible, and for some of which he is not, for the jury to guess between these half a dozen causes, and find that the negligence of the employer was the real cause, when there is no satisfactory foundation in the testimony for that conclusion."

In *Frame v. Prudential Insurance Company of America,* 56 Atl. (2d) 76, the Court stated that the fact, as a mere matter of speculation, there may have been a contributing factor to death of the insured other than external, violent and accidental means does not preclude a recovery under accidental death provisions of the life policy. The Court went on to say that the right to recover on the policy was barred only if there was, in fact, such a contributing factor, not if, as a mere matter of speculation, there may have been. The case of *Kelley v. Pittsburgh Casualty Company,* 100 Atl. 494, (Penn.) the court was called upon to construe a similiar provision in a double indemnity life insurance policy. The Court stated, at page 495 of that opinion:

> "Our position at the trial may be well defined, substituting the word 'disability' for the word 'death', by an extract from 5 Ann. Cas., pp. 86, 87, which is as follows:
>
> " 'If disease, while existing, be but a condition, and the accident the moving, sole, and proximate cause of the death, the exception in the policy will not relieve the insurer for death so caused. Thus it has been said that, if an insured should suffer

death by drowning, no matter what the cause of his falling into the water, whether disease or slipping, the drowning in such case would be the proximate and sole cause of the death, unless it appeared that death would have been the result, even had there been no water at hand. . . .'

"So it seems death due to chronic alcoholism and a broken limb is not within the exception, if the proximate cause of death is the accident and resulting injury. . . . Death due to a fall caused by a sudden ailment or disorder is not the result of disease within the meaning of an exception in a policy; the fall being the sole and proximate cause of death. . . . The same is true in case of death caused by a fall rupturing an artery weakened by a tumor."

In the case of *Doke v. United Pacific Insurance Co.*, 15 Wn. (2d) 536, the Supreme Court has recognized that a presumption of "accidental means" arises when there has been established that a death was the result of external and violent means. At page 544-545 of that opinion, the court stated:

"The next question is whether the burden was on the appellant to show the manner in which the accident occurred.

"In 29 Am. Jur. 1082, sec. 1443, after stating the general rule that the plaintiff in an accident insurance policy must prove that the death or injury for which the action is brought must be caused by accidental means, within the terms of the policy, this is said:

" 'In this respect, the authorities support the general rule that in an action on a policy insuring against death caused solely by external, violent, and accidental means, the burden of proof is on the plaintiff to show from all the evidence that

> the death of the insured was the result of accidental as well as external and violent means, but that where death by unexplained, violent, and external means is established, a presumption is thereby made of the fact that the injuries were accidental, without direct and positive testimony on that point, since the law will not presume that the injuries were inflicted intentionally by the deceased or by some other person.' "

Cox v. Polson Logging Company, 18 Wn. (2d) 49 at page 68:

> "This court has repudiated the so called scintilla of evidence rule and has repeatedly held that evidence sufficient to support a verdict must be substantial."

In this case now before the court, it was encumbent upon the court to find sufficient evidence in the case to meet defendant's burden of proof by a preponderance of the evidence that an exclusion or exception was applicable, not a finding or a verdict based on conjecture or speculation. Once a prima facie case is made for the plaintiff, if there is not a preponderance of the evidence admitted for the defendant, the verdict must be for the plaintiff.

Expert and Non-Expert Testimony:

The only expert to testify as what he felt was based on more than mere conjecture or speculation was Dr. Hill. The testimony of Peter Dix should have been admitted as a layman's testimony. Offer of proof was made as to Dix's testimony (R-23) but the evidence was not admitted by the court and could not be taken

into consideration on hypothetical question later in the trial.

In the case of *Graham v. Police & Firemen's Ass'n.*, 10 Wn. (2d) 288, our Court held that a layman, who has had an opportunity to draw a conclusion as to the cause of death, after making sufficient observations may testify as to those conclusions. At page 295 of that opinion:

> "In determining questions such as presented in this case, Court and juries must accord great weight to the evidence given by physicians. They may, however, consider the testimony of non-experts when it is based upon observation and the opportunity to draw a conclusion. In cases where the information is the result of familiar association, a layman, may testify to disposition, appearance, and physical condition of an individual."

The rule stated in the *Graham* case, supra, was reiterated with approval in *Arthurs v. National Postal Trans. Ass'n.*, 49 Wn. (2d) 570, at page 578:

> "Although, in determining the cause of death, great weight must be accorded to the evidence of physicians, the testimony of non-experts may be considered when it is based upon observation; and in cases where the information is the result of familiar association, a layman may testify to disposition, appearance, and physical condition of an individual. . . ."

At 20 Am. Jur. 1206, page 1257, it states as to expert opinion testimony:

> "When expert opinions differ, the care and accuracy with which the experts have determined

the data upon which they have their conclusions are to be considered. Opinion testimony founded upon facts within the knowledge and experience of the witness and supported by good reasons is likely to receive greater credence and carry more weight than a purely speculative theory or one which is rendered by persons not qualified in the field about which they testify. . . .

"Positive expert testimony will prevail over negative expert testimony." 97 ALR 1399, 41 P. (2d) 605.

In the case of *Orcutt v. Spokane County,* 58 Wn. (2d) 846, at page 853, the court stated:

"We have often held that in actions in which recovery is sought for physical conditions allegedly resulting from injuries inflicted by the wrongful act of the defendant, the finding must produce evidence to establish, with reasonable certainty, a causal relationship between the injury and the subsequent condition, so that the jury will not be indulging in speculation and conjecture in passing upon the issue. (Citing cases) Although we have held this may be established by circumstantial evidence, medical testimony is necessary when the causal relationship is not clearly disclosed by the circumstantial evidence. Moreover, we have held this medical testimony must at least be that the injury 'probably' or 'more likely than not' caused the subsequent condition, rather than that the accident or injury 'might have,' 'could have,' or 'possibly did' cause the subsequent condition. (Citing cases.)"

In the case at hand, medical witnesses who testified on behalf of the defendant admitted that their testimony was based upon speculation or conjecture.

Injury or Wounds:

There was more than sufficient evidence to sustain a verdict on external wounds in that Dr. Kalez stated that it looked like deceased's neck could be broken (R-148). Hayes, the embalmer, found discoloration on his neck and jaw that looked like a bruise (R-225). And further, the deceased's brother, John George, noticed the same bruise and discoloration in the same area prior to the funeral of deceased (R-109).

In *Hodgkinson v. Dept of Labor & Industries,* 52 Wn. (2d) 500, an "injury" is described as follows:

> " 'Injury' means a sudden and tangible happening, of a traumatic nature, producing an immediate or prompt result, and occurring from without; an occupational disease; and such physical condition as results from either."

A further definition of "injury" appears in 29 Am. Jur. 315-316, sec. 1168:

> ". . . An accidental bodily injury has been defined as a localized abnormal condition of the living body, directly caused by accident. . . ."

Another definition which is noteworthy in the instant case is that of "visible contusion or wound." In the case of *Hill v. Great Northern Life Ins. Co.,* 186 Wash. 167, the court states, at page 173:

> "The words, 'visible mark or evidence of injury,' and similar expressions used in accident insurance policies such as we have here, are not construed in the strict and narrow sense of a

bruise, contusion, laceration, or fracture, but in the broad sense of something that is discernible, perceptible or evident upon observation. 6 *Couch on Insurance,* sec. 1265. This is the general rule that is followed in this state. In *Horsfall v. Pacific Mutual Life Ins. Co.,* 32 Wash. 132. . . . where the identical question was presented, this court said:

" 'It is also urged that the injuries causing death left no visible external mark, produced at the time of and by the accident, upon the body of deceased, and therefore the injury was one excepted from the policy. The evidence as stated above shows that immediately after the accident the deceased became deathly pale and sick, his hands and feet became cold, and the perspiration stood out on his face and hands. The next day after the accident his skin, which previously had been ruddy, became a bluish gray color, and remained so until his death. These, we think, were visible external marks, and sufficient to bring the case within the terms of the policy. (Citing authorities)' "

Also, in 29 Am. Jur. 319-320, sec. 1173, Visible Contusions and Wounds:

"In some policies provision is made for indemnity or increased indemnity in case of death or injury by accidental means of which there is a visible 'contusion or wound.' The purpose of such a provision is to have visible and physical evidence of the means which are alleged to have effected the bodily injuries.

"The words 'contusion' and 'wound' as thus used have been variously defined. The term 'visible contusion,' as used in a provision of a life insurance policy for double indemnity where death occurs as a result of bodily injuries effected by ex-

CERTIFICATE OF COUNSEL

WILLIAM B. BANTZ, one of the attorneys for the appellant, states:

I certify that, in connection with the preparation of the brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

.....

Attorney for Appellant

No. 20063

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

A. & E. Plastik Pak Co., Inc.,

Appellant,

vs.

William N. Bowie, Jr., Trustee,

Appellee.

APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

I.

ARGUMENT.

A. The Restraining Order Prevented Trial of Appellant's Municipal Court Case From Proceeding to Judgment.

Reference is made to the statement on page 2 of Appellee's Brief that a trial of the Municipal Court case has not been had. The Municipal Court case was set for trial on July 27, 1964 but the Referee's Restraining Order prevented the case from going to trial and the said Restraining Order is still in effect. The Referee's original Restraining Order was issued May 28, 1964.

B. The Trustee's Title Is Subject to the Attachment Lien.

Reference is made to the contentions of Appellee's Brief on pages 6, 7 and 8 thereof that since title to the attached funds passes to the creditor only after Judg-

ment, the Trustee in Bankruptcy is vested with title thereto under Section 70(a)(5) of the Bankruptcy Act (11 U.S.C.A. §110). This is a *non sequitur*. Appellant does not claim *title* to the attached funds but only an *attachment lien* with respect thereto. The title which the Trustee receives under §70 is *subject to the attachment lien,* even though it is contingent upon success of the litigation, since the Trustee takes the property *subject to all valid claims, liens and equities.*

4 Collier on Bankruptcy, §70.04, p. 954.1;

Zartman v. First National Bank of Waterloo, 216 U.S. 134 (1910);

Anglo Bank v. Schenley Industries, Inc., 215 F. 2d 651 (9 Cir., 1954);

Hyman v. McLendon, 140 F. 2d 76 (4 Cir., 1944).

Section 70(a)(5) vests the Trustee with title by operation of law to Bankrupt's property ". . . which prior to the filing of the Petition he could by any means have transferred . . ." The Bankrupt could not have transferred the attached monies prior to Bankruptcy free of the attachment lien under California Law and the Trustee take no better title to the funds.

6 Cal. Jur. 2d, §131.

C. Appellee Misconstrues Metcalf v. Barker.

Appellee refuses to accept the facts as set forth in the reported decision of *Metcalf v. Barker,* 187 U.S. 165 (1902), and as viewed by the U.S. Supreme Court in its opinion with respect thereto. The creditors suit therein creating a contingent, equitable lien was commenced December 17, 1895 and Judgment was not entered there-

on until January 31, 1899, within four months of the bankruptcy of May 12, 1899. For the U.S. Supreme Court's rejection of the contention that title passed to the Trustee free of the lien, because the equitable lien involved was admittedly "contingent", see the quotations from the U.S. Supreme Court opinion on pages 8 and 9 of Appellant's Opening Brief.

If the present eleven month old attachment is invalid, what is meant by the provisions of Section 67 of the Bankruptcy Act (11 U.S.C.A. §10) which specifically makes null and void all attachments obtained at any time *within four months* prior to the filing of the Petition in Bankruptcy? Appellee seeks to delete from the Statute the three italicized words.

Metcalf v. Barker has already answered this question in holding that when the contingent lien is obtained more than four months prior to the filing of the Petition, ". . . its validity is recognized . . ." The *Metcalf* decision further states that ". . . if this were not so the date of the acquisition of a lien by attachment or creditor's bill would be entirely immaterial . . ."

D. Appellee Does Not Explain Why Section 60 Should Not Apply.

On page 10 of Appellee's Brief, referring to Section 60 of the Bankruptcy Act (11 U.S.C.A. §96) Appellee does not in any way refute the Appellant's position that since Section 60 defines an attachment within four months of bankruptcy as a preference, attachments *over* four months prior to bankruptcy are *not* preferences under the Bankruptcy Act. Appellee, without citing authority, merely states that ". . . Section 60 of the Act cannot and should not be applied . . ."

E. No Authority Is Cited for the Trustee's Position.

It is important to note that Appellee can cite *no case* where an attachment preceding bankruptcy by over four months was invalidated. Certainly it is not unreasonable to require Appellee to cite some authority for its new, novel, and unique position which is contrary to the case law and completely out of harmony with the Bankruptcy Act.

II.

CONCLUSION AND PRAYER.

The Appellee's position is not supported by either case law or statute and is completely contrary to express provisions of the Congressional enactments on the subject of Bankruptcy. It is clear from the Bankruptcy Act that attachments perfected over four months prior to bankruptcy are exempted from any claim by the Trustee in facts such as exist in the case at bar.

Wherefore, Appellant respectfully prays that the Order of the United States District Court affirming the Order of the Referee in Bankruptcy be reversed and that Appellant be awarded its costs together with such other relief as is appropriate under the circumstances.

Respectfully submitted,

MEYER BERKOWITZ,
Attorney for Appellant.

Certificate.

I certify that in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing Brief is in full compliance with those Rules.

MEYER BERKOWITZ

No. 20063

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

HOLLAND BULB IMPORTERS, INC.,

Bankrupt.

WILLIAM N. BOWIE, JR., Trustee,

Appellee,

vs.

A & E PLASTIK PAK CO., INC.,

Appellant.

APPELLEE'S BRIEF

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APPELLEE'S BRIEF

I.

STATEMENT OF THE CASE

The facts are undisputed. The Trustee in Bankruptcy filed an Application for Stay of State Court proceedings, Restraining Order and Order to Show Cause to prohibit A & E PLASTIK PAK CO., INC., its agents or employees, from prosecuting a State Court action against HOLLAND BULB IMPORTERS, INC., prohibiting the Marshal of the

County of Los Angeles from disbursing any money or property under attachment to said creditor, and ordering the Security First National Bank to surrender to the Trustee any monies or properties held under any levies by said creditor.

A & E PLASTIK PAK CO., INC., is a California corporation and a general creditor of HOLLAND BULB IMPORTERS, INC., the above entitled Bankrupt. On December 11, 1962, said creditor filed a suit in the Municipal Court of Los Angeles Judicial District in Los Angeles, California, against the Bankrupt herein and others, being Case No. 948,190 and captioned "Complaint for Money."

On December 12, 1962, the Los Angeles County Marshal levied a Writ of Attachment on Security First National Bank, pursuant to said litigation hereinabove referred to, and on December 13, 1962, the Bank made a "not indebted" return of said attachment.

Thereafter, A & E PLASTIK PAK CO., INC., caused proceedings to be had against the Bank pursuant to California Code of Civil Procedure, Section 545, and on January 30, 1963, the Bank made. issued and delivered an amended return to said Writ of Attachment stating that said Bank was holding under and in response to the said Writ of Attachment, the balance of Account No. 078,675, in the name of HOLLAND BULB IMPORTERS, INC., the sum of $2,579.02.

A trial in the Municipal Court of Los Angeles Judicial District in Case No. 948.190 has not as yet been heard, nor has a judgment been obtained in said proceedings.

An Involuntary Petition in Bankruptcy was filed by Creditors against the Bankrupt herein in the United States District Court, Southern District of California, Central Division, on November 18, 1963, and HOLLAND BULB

IMPORTERS, INC., was adjudged a Bankrupt on December 13, 1963. On April 1, 1964, WILLIAM N. BOWIE, Jr., was duly appointed and qualified as Trustee of said Bankrupt Estate and ever since the said date, he has been and is the acting and qualified Trustee of said Bankrupt Estate.

The Trustee, herein, claimed that the Attachment lien obtained by A & E PLASTIK PAK CO., INC., under the laws of the State of California, is and was contingent and inchoate, and is merely a "Lis Pendens" notice that a right to perfect a lien exists. The Trustee further claimed that due to the fact that no judgment has been obtained by said creditor prior to the filing of the Petition in Bankruptcy on November 18, 1963, no transfer of the property of the Bankrupt to said creditor occurred, and that under Section 70(a) of the Bankruptcy Act, title to the Bankrupt's property vested in the Trustee on said date.

The debt arising from the debtor-creditor relationship herein referred to, between the bankrupt and A & E PLASTIK PAK CO., INC., is the type of debt dischargeable in Bankruptcy. Neither the creditor nor the Bank objected to the Court's summary jurisdiction in this proceeding.

The Honorable Norman W. Neukom, Referee in Bankruptcy, in his findings of fact and conclusions of law, after having reviewed both oral and written arguments of all parties hereto, ruled that the attachment lien obtained by A & E PLASTIK PAK CO., INC., is and was contingent and inchoate and is merely a Lis Pendens notice that a right to perfect a lien exists. The Bankruptcy Court further felt that it was bound by the holding of the Ninth Circuit Court in the case of *Rialto Publishing Company v. Bass*, 325 F.2d 527, C.C.A. 9th (1963), where it was

held that no transfer occurred until such time as the creditor obtained its judgment and levied execution thereon.

The Bankruptcy Court thereupon granted the Trustee a Restraining Order against A & E PLASTIK PAK CO., INC., from proceeding against the attached funds of HOLLAND BULB IMPORTERS, INC., in said State Court action, and the Court further restrained said creditor from proceeding against any monies which may be held by the Security First National Bank under said amended return to a Writ of Attachment dated January 30, 1963.

On November 4, 1964, A & E PLASTIK PAK CO., INC., feeling aggrieved by the Order of October 30, 1964, of the Bankruptcy Court herein, filed a Petition for Review.

On review to the District Court, the findings of fact and conclusions of law of the Honorable Norman W. Neukom were affirmed and adopted by the Honorable Harry C. Westover, Judge of the District Court.

II.

SUMMARY OF ARGUMENT

The Appellant's opening brief (pp. 2 & 3) and Appellee's Statement of the Case, hereinabove, demonstrate that there are no disputes as to the facts of the case at bar. The Application of the Trustee was to set aside the lien obtained by the attachment where the creditor obtained no judgment and consequently there was no subsequent execution. However, appellant's statement of questions involved on Appeal (App. Br. p. 3) indicate two questions for this Court to consider, whereas the Appellee's contention is that this Court should consider only the following:

Is the Trustee in Bankruptcy vested with title to funds on which a creditor has obtained a writ of attachment over eleven months prior to bankruptcy, but where said creditor has obtained no judgment prior to the filing of the petition in bankruptcy?

It is the contention of the Trustee that the attachment lien obtained by said creditor on the personal property of the Bankrupt vested in the Trustee on November 18, 1963. The mere attachment of said personal property of the bankrupt by said creditor did not constitute a transfer and that title to said personal property remained in the debtor and bankrupt up to the date of bankruptcy, when said funds vested in the Trustee by operation of law.

III.

ARGUMENT WITH POINTS AND AUTHORITIES

A. An Attachment of Personal Property under the Laws of California Does Not Constitute a Transfer to Attaching Creditor.

Attachment in California is not a remedy but is merely ancillary to the ultimate goal, viz., the recovery of a judgment.

Vol. 1, Witkin's California Procedure, p. 888.

It is contingent and uncertain in its terms being dependent upon an outcome of the proceedings favorable to the plaintiff. It does not affect the title of the debtor to the property.

6 Cal. Jur. 2d, p. 338.

"The plaintiff, at the time of issuing the summons, or at any time afterward, may have the property of the defendant attached, as security for the satisfaction of any

judgment that may be recovered, unless the defendant gives security to pay such judgment, . . ."

California Code of Civil Procedure, Section 537.

The answer to the issue at bar hinges on the characteristics of an attachment under the laws of the State of California.

Erie Railroad Co. v. *Tompkins,* 304 U.S. 64, 82 L. Ed. 1188.

In *Ward* v. *Commissioner of Internal Revenue,* 224 F. 2d 547, which arose in this circuit in 1955, the court, consisting of the Honorable Richard H. Chambers, the Honorable Albert Lee Stephens and the Honorable Leon J. Yankwich, in discussing the law in California as to attachments, stated at page 551:

> "Under California law an attachment is an auxiliary proceeding . . . the attachment is merely a sequestration of the debtor's funds to abide the judgment. They will remain the property of the debtor and title to them passes to the attaching creditor *only* after a judgment in his favor has been entered in which case the lien of the attachment is merged in the judgment." (Emphasis added).

If title to the funds passes only after a judgment, the argument of the Appellant that the Bankruptcy Act exempts from the reach of a Trustee any attachment perfected over four months before the filing of a Petition in Bankruptcy is a fiction not substantiated by law or logic.

> "The Trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property

> which is held to be exempt, to all of the following kinds of property wherever located . . . (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered:"
>
> *Section 70 (a) (5) Bankruptcy Act (11 U.S.C.A. Sec. 110).*

"Transfer" is defined in Section 1039 of the Civil Code of the State of California to be ". . . an act of the parties, or of law, by which the title to the property is conveyed from one living person to another."

It would therefore appear that the word "transfer" as used in the Bankruptcy Act is interpreted under the laws of California and in view of the above section of the Civil Code of the State of California quite apparently title to the funds has not passed to the appellant by virtue of the writ of attachment. It would also appear that not even possession of the funds attached has passed to the creditor-appellant under the writ of attachment.

In *United States* v. *Security Trust and Savings Bank,* 340 U.S. 47, 95 L. Ed. 53, the question presented was whether a tax lien of the United States was prior in right to an attachment lien where the Federal tax lien was recorded subsequent to the date of the attachment lien but prior to the date the attaching creditor obtained judgment. In determining and interpreting the law in California as to the status of the attachment, the Supreme Court of the United States stated at page 50:

> ". . . if the State court itself described the lien as inchoate, this classification is practically conclusive. . . . The Supreme Court of California has so described the attachment lien in the case of *Puisseur* v. *Yar-*

> *brough,* 29 Cal. 2d 409, 412, 175 P.2d 830, 831, by stating that the attaching creditor obtains only a potential right or contingent lien . . . Examination of the California statute shows that the above is an apt description. The attachment lien gives the attaching creditor no right to proceed against the property unless he gets a judgment within three years or within such extension as the statute provides. Numerous contingencies might arise that would prevent the attachment from ever becoming perfected by a judgment awarded and recorded. *Thus the attachment lien is contingent or inchoate—merely a lis pendens notice that a right to perfect the lien exists.*" (Emphasis added)

Rialto Publishing Company v. *Bass,* 325 F.2d 527, which case was decided in this Circuit in 1963, held that each appellant's asserted attachment lien, by the initial California court attachment alone, and without subsequent court judgment thereon, became only and no more than "a potential right or a contingent lien."

It is entirely possible that the law in states other than California give much more effect to an attachment lien than does the law in California. The effect, however, of the use of attachments in California must be determined by California law.

> *Erie Railroad Co.* v. *Tompkins,* 304 U.S. 64, 82 L. Ed. 1188.

B. The Order of the Referee Is Not Contrary to Metcalf v. Barker.

The Appellant relies on the case of *Metcalf* v. *Barker,* 187 U.S. 165 (1902) as being decisive of the issues involved herein.

The facts of that case show that Metcalf Brothers obtained confessions of JUDGMENT on October 22, 1896, in the Superior Court of the State of New York against Lesser

Brothers, a co-partnership. Executions were issued and returned unsatisfied at that time.

On December 17, 1896, Metcalf Brothers commenced a Judgment Creditors' action in the Supreme Court of New York and thereupon the creditors of the partnership brought the action to avoid the transfers of the co-partnership so executed on.

It is urgent and indispensible to note that Metcalf Brothers had obtained a judgment at the outset. Their attachment was predicated on said judgment. If the facts of the case at bar were identical to the Metcalf case, there is little doubt that the lien so obtained by the judgment would be choate and the trustee could not prevail.

However, in the instant case, there is no JUDGMENT. There is merely an action filed and an attachment lien filed on personal property of the bankrupt. The attachment lien is merely "inchoate" as defined in the *Rialto Publishing Company* v. *Bass, supra,* and upon the filing of a petition in bankruptcy, title to said property so attached passes to the Trustee in Bankruptcy by operation of law.

C. The Trustee Does Not Necessarily Take the Property Subject to All Valid Claims, Liens and Equities.

In the Matter of Monticello Veneer Co., (D.C., Miss.) 22 Am. B. R. (N.S.) 249, 2 F. Supp. 27, where it was said:

> "Because the Bankruptcy Act measures the extraordinary rights of the Trustee by the sum of the rights of the bankrupt, of creditors, and of other parties dealing with him, it follows that the trustee does not always occupy merely the status of the bankrupt but frequently may get a better title than the bankrupt had, or, in some cases, get title when the bankrupt had none."

The Trustee takes such property not as a bona fide purchaser but in the dual role of a successor to the title of the bankrupt himself and of a creditor with a lien acquired through legal or equitable proceedings. Moreover, certain transfers, including certain liens, are voidable by the trustee under positive provisions of the Bankruptcy Act.

4 Collier on Bankruptcy, Section 70.04, p. 958.

D. Section 60 of the Bankruptcy Act (11 U.S.C.A. §96) Which Validates Inchoate Attachment Liens Within Four Months Prior to Bankruptcy Does Not Apply.

The Appellant seeks to invoke Section 60 of the Bankruptcy Act to the case at bar. Appellee contends that due to the fact that no judgment or execution on a judgment has been obtained by the creditor herein, Section 60 of the Bankruptcy Act cannot and should not be applied to the situation in the case at bar.

There has been no transfer of the funds under attachment from the debtor to the creditor prior to the filing of the Petition in Bankruptcy.

IV.

CONCLUSION AND PRAYER

An attachment lien without benefit of judgment and execution prior to a petition in bankruptcy creates a mere contingency and does not constitute a transfer of the bankrupt's property. The *Rialto, Puissegur, Ward* and other cases cited by Appellee herein show the holding of various courts, including this Circuit Court, on application of facts hereinabove stated.

Wherefore, your appellee submits that the decision of the Honorable District Judge granting the Restraining Order be sustained.

Respectfully submitted,

A. S. GOLDMAN,
LEONARD A. GOLDMAN and
EARLE HAGEN,
By EARLE HAGEN,
Attorneys for Appellee.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

EARLE HAGEN.

No. 20063

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

A. & E. Plastik Pak Co., Inc.,

Appellant,

vs.

William N. Bowie, Jr., Trustee,

Appellee.

APPELLANT'S OPENING BRIEF.

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No. 20063

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Appellee.

APPELLANT'S OPENING BRIEF.

I.

STATEMENT OF JURISDICTION.

The Referee had jurisdiction of this matter pursuant to Title 11, *U.S.C.A.* §11, conferring jurisdiction over bankruptcy matters upon the Courts of Bankruptcy, together with Title 11, U.S.C.A. §46(b), which enlarges the said jurisdiction by consent of the defendant. The United States District Court had jurisdiction to review the Order of the Referee pursuant to Title 11, *U.S.C.A.* §67(c), which grants to a person aggrieved by an Order of a Referee the right to petition for review of said Order by a Judge of the District Court. This Court of Appeals for the Ninth Circuit has jurisdiction over this Appeal pursuant to Title 11, *U.S.C.A.* §47(a), which grants to this Court Appellate jurisdiction over controversies arising in proceedings in bankruptcy.

II.
STATEMENT OF THE CASE.

Appellant, A. & E. Plastik Pak Co., Inc., a California corporation (hereinafter referred to as "A. & E.") is a creditor of Holland Bulb Importers, Inc., Bankrupt (hereinafter referred to as "Holland Bulb"). Appellee, William N. Bowie, Jr. (hereinafter referred to as the "Trustee") is the Trustee in Bankruptcy of Holland Bulb [T. R. p. 3]. On December 11, 1962, over eleven months prior to the filing of the Involuntary Petition in Bankruptcy, A. & E. filed suit on its claim against Holland Bulb and others in the Municipal Court of Los Angeles Judicial District, located in Los Angeles, California, and pursuant to said litigation, on December 12, 1962, caused the Los Angeles County Marshal to levy a Writ of Attachment upon the bank account of Holland Bulb at Security First National Bank (hereinafter referred to as "the Bank"). On December 13, 1962, the Bank made a "not indebted" return on said Attachment, but on January 30, 1963, as a result of proceedings against the Bank pursuant to *California Code of Civil Procedure,* §545, the Bank made an amended return to the Writ of Attachment stating that the Bank was holding $2,579.02 in Holland Bulb's Account No. 078675 [T. R. p. 3]. A. & E.'s claim against Holland Bulb exceeds the amount of $2,579.02 [T. R. p. 4].

It is undisputed that the Attachment of A. & E. was a valid and existing Attachment under California law, having all of the characteristics incident thereto, and that the said Attachment existed as of December 12, 1962, over eleven months prior to the filing of the Involuntary Petition in Bankruptcy hereinafter referred

to [T. R. p. 4]. On November 18, 1963, an Involuntary Petition in Bankruptcy was filed against Holland Bulb, and thereafter, adjudication as a bankrupt occurred on December 13, 1963 [T. R. p. 5]. A. & E. did not know, nor have reason to believe, that Holland Bulb was insolvent at any time prior to November 18, 1963 [T. R. p. 6].

On June 2, 1964, the Trustee filed an Order To Show Cause and Petition, pursuant to which the Court issued a temporary Restraining Order restraining A. & E. from proceeding with the Municipal Court suit which had been set for trial July 27, 1964 [T. R. pp. 2, 4]. Hearings were had on the said Order To Show Cause, and the Referee, on October 30, 1964, concluded that the Trustee was vested with title to the attached funds [T. R. p. 6] and made its Order restraining A. & E. from proceeding against the attached funds of Holland Bulb, or against any monies of Holland Bulb held by the Bank pursuant to the amended return to the Writ of Attachment dated January 30, 1963 [T. R. pp. 8, 9]. On Petition for Review the United States District Court, on March 11, 1965, affirmed the Order of the Referee [T. R. p. 10]. On March 22, 1965, Notice of Appeal to this Court was filed [T. R. p. 12].

The questions involved in this Appeal are as follows:

(1) Is a valid California Attachment perfected over eleven months prior to bankruptcy voidable under The Bankruptcy Act?

(2) Is the Trustee in Bankruptcy Vested with title to funds which are subject to a valid California Attachment Lien obtained over eleven months prior to bankruptcy?

Appellant contends that both of the above questions should be answered in the negative, and that the Order of the District Court affirming the Order of the Referee should be reversed.

III.
SPECIFICATION OF ERRORS.

Appellant contends that the Order below is based upon the following errors contained in the Conclusions of Law and Order of the Referee:

(1) The Order of the Referee is based upon the erroneous conclusion that the time of acquisition of a valid California Attachment is immaterial to the Trustee's Claim of Title.

(2) Conclusion of Law Number IV [T. R. p. 6] is in error in that it vests with the Trustee by operation of law the title to the proceeds of an Attachment, valid and existing under California law, which Attachment existed over eleven months prior to the filing of the Involuntary Petition In Bankruptcy herein.

(3) Conclusions of Law Numbers III, IV, VI and VII [T. R. pp. 5, 6, 7] are erroneous in that they are based upon the erroneous legal conclusion to the effect that a perfected Attachment under California law existing over eleven months prior to the filing of the Involuntary Petition In Bankruptcy herein vests title to the attached property in the Trustee, free of the Attachment lien, upon the filing of the Petition In Bankruptcy.

(4) The entire Order of the Referee hereinabove referred to is based upon the erroneous con-

clusion of law to the effect that funds attached by a creditor of bankrupt over eleven months prior to the filing of the Petition In Bankruptcy, at a time when the creditor did not know, or have reason to believe that the bankrupt was insolvent, may nevertheless be seized by the Trustee in Bankruptcy as assets of the bankrupt estate, and the granting of a Restraining Order as a consequence thereof was and is erroneous.

IV.
ARGUMENT.

A. Summary of Argument.

A California attachment perfected over four months prior to the filing of a Petition in Bankruptcy is not voidable under the Bankruptcy Act. Title to the Bankrupt's property which is vested in the Trustee is subject to all valid claims, liens and equities and is subordinate to a California attachment perfected over four months prior to filing. The rule of *Rialto Publishing Co. v. Bass,* 325 F. 2d 527 (9 Cir. 1963) is limited to situations where the attachment was made *within* the four months prior to the filing of a Petition in Bankruptcy.

B. An Attachment Perfected Over Four Months Before Bankruptcy Is Not Voidable Under the Bankruptcy Act.

The Bankruptcy Act exempts from attack by the Trustee any Attachment perfected over four months before the filing of the Petition in Bankruptcy. *4 Collier on Bankruptcy*, Paragraph 67.07, pp. 88, 89. This has been the unchallenged posture of the law since 1902,

when *Metcalf v. Barker,* 187 U.S. 165 (1902) held that an Attachment obtained more than four months prior to the filing of the Petition in Bankruptcy is expressly recognized by The Bankruptcy Act as valid.

It has even been held that although the Levy of Attachment merely perfects an "inchoate" lien arising over four months prior to bankruptcy, the Attachment is valid although levied within the four months period prior to the filing in Bankruptcy. *4 Collier On Bankruptcy,* Paragraph 67.07, pp. 90, 91; *Irby v. Covey,* 95 F. 2d 963 (5 Cir.) (Attachment perfecting an inchoate landlord's lien); *Brown Shoe Co. v. Wynne,* 281 Fed. 807 (5 Cir.), reversing *Matter of Wright & Weissinger* (D.C. Miss.), 277 Fed. 514.

The Court of Appeals for the Ninth Circuit has heretofore held that a California Attachment obtained prior to the four month period preceding the filing in Bankruptcy was valid against the Trustee in Bankruptcy reversing the U.S. District Court which held otherwise. *In re Maier Brewing Co., Inc.,* 65 F. 2d 673 (9 Cir., 1933), cert. den. *sub nom. Wells v. Simons,* 290 U.S. 695.

C. The Order of the Referee Is Erroneous Under Section 70 of the Bankruptcy Act.

Sec. 70 of the Bankruptcy Act (11 *U.S.C.A.* §110) refers to the title to the Bankrupt's property which is vested in the Trustee. Sec. 70 merely vests title in the Trustee to the Bankrupt's property, but does not vest in the Trustee any better right or title than that which belonged to the Bankrupt at the time when the Trustee's title accrues. The Trustee takes the property *subject to all valid claims, liens, and equities.*

This is clearly set forth in *4 Collier On Bankruptcy,* Paragraph 70.04, beginning at p. 954.1 as follows:

> "The Courts are frequently moved to reassert the general rule that the act 'does not vest the Trustee with any better right or title to the Bankrupt's property than belongs to the Bankrupt or his creditors at the time when the Trustee's title accrues'. This is true in that the Bankruptcy Trustee is not a bona fide purchaser or encumbrancer for value, but takes the property *subject to all valid claims, liens and equities."*
>
> *Zartman v. First National Bank of Waterloo,* 216 U.S. 134 (1910);
>
> *Anglo Bank v. Schenley Industries, Inc.,* 215 F. 2d 651 (9 Cir., 1954);
>
> *Hyman v. McLendon,* 140 F. 2d 76 (4 Cir., 1944).

The only transferred property which is vested in the Trustee pursuant to §70, insofar as is here applicable, *is property wherein the liens obtained were within four months of bankruptcy, and preferential transfers of the Bankrupt's property effected within the four month period.*

4 Collier on Bankruptcy, §70.04, p. 957.

D. The Order of the Referee Is Contrary to Metcalf v. Barker.

The case of *Metcalf v. Barker, supra,* is decisive of the issues presented. In that case a creditor's suit, which operates as an equitable lien on the debtor's property, was commenced by plaintiff on December 17, 1895, and Judgment was entered thereon January 31, 1899. Bankruptcy followed on May 12, 1899, and the

attorney for the Trustee in Bankruptcy contended that inasmuch as the Judgment was obtained within the four month period, the title to the property upon which the lien attached was in the Trustee, free and clear of the lien, since the previous equitable lien which preceded the Judgment was "inchoate".

The U.S. Supreme Court rejected this argument and held that the December 17, 1895 lien was good against the Trustee. The Court in the *Metcalf* case stated in part as follows, commencing on page 172:

> "Doubtless the lien created by a Judgment creditor's bill is contingent in the sense that it might possibly be defeated by the event of the suit, but in itself, and so long as it exists, it is a charge, a specific lien, on the assets, not subject to being divested save by payment of the Judgment sought to be collected."

The *Metcalf* decision also discussed the matter of the constitutional power of Congress to displace valid statutory liens as distinguished from the intention of Congress to do so, and concluded from an examination of the Bankruptcy laws that Congress had never attempted to do so. No change in the Bankruptcy laws would cause the decision to be different today since §67, referred to in the *Metcalf* decision, is little changed. §67 of The Bankruptcy Act (11 *U.S.C.A.* §107) makes all levies, judgments, attachments or other liens obtained through legal or equitable proceedings against a person who is insolvent, at any time within four months prior to the filing of a Petition in Bankruptcy, null and void.

The *Metcalf* decision stated on this subject as follows on page 174:

> "In our opinion the conclusion to be drawn from this language is that it is the lien created by a levy, or a judgment, or an attachment, or otherwise, that is invalidated, and that *where the lien is obtained more than four months prior to the filing of the petition, it is not only not to be deemed to be null and void on adjudication, but its validity is recognized.* When it is obtained within four months the property is discharged therefrom, but not otherwise. A judgment or decree in enforcement of an otherwise valid pre-existing lien is not the judgment denounced by the statute, which is plainly confined to judgments creating liens. *If this were not so the date of the acquisition of a lien by attachment or creditor's bill would be entirely immaterial.*" (Emphasis added)

Accordingly, the Supreme Court held that despite the fact that the December 17, 1895, equitable lien was "contingent" and "inchoate," it was in fact a valid lien subject to contingencies, and that inasmuch as it was obtained prior to the four month period preceding bankruptcy, it was valid and could not be set aside at the instance of the Trustee.

The *Metcalf* decision is decisive of the issue presently before this Court. The A. & E. Attachment, over eleven months prior to bankruptcy, could not be nullified by the Trustee.

E. The Order of the Referee Is Erroneous Under Section 60 of the Bankruptcy Act (11 U.S.C.A. §96) Which Validates Inchoate Attachment Liens Obtained Four Months Prior to Bankruptcy.

§60 of The Bankruptcy Act, subdivision (a)(1), provides that a preference is a transfer of any of the property of debtor to or for the benefit of a creditor for or on account of an antecedent debt ". . . made or suffered by such debtor while insolvent and *within four months before the filing* by or against him of the Petition initiating a proceeding under this Act. . . ."

§60(a)(2) provides that a transfer of personal property is deemed to have been made or suffered at the time when it became so far perfected ". . . that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. . . ."

Subdivision (a)(4) *specifically provides* that a lien "obtainable by legal or equitable proceedings" is a lien arising ". . . upon *Attachment, Garnishment,* Execution or like process, *whether before,* upon, *or after* Judgment or Decree and whether before or upon levy." (Emphasis added).

Any lien obtained through judicial proceedings is a transfer within the meaning of §60 of The Bankruptcy Act. *3 Collier On Bankruptcy,* Paragraph 60.46, p. 1014. The steps necessary to create such a lien and the point of time when such lien becomes perfected depends upon local law. *3 Collier On Bankruptcy,* Paragraph 60.46, p. 1014.

Under California law, the general rule that an Attachment operates as a lien from the time of the levy,

is applicable. *6 Cal. Jur. 2d,* §131, p. 40. Where the Attachment has been properly made, no subsequent lien upon such property can displace it, and the rule "First in Time, Stronger in Right" applies. *6 Cal. Jur.* 2d, §137, p. 45. The same rule applies between Attachments and other liens. *6 Cal. Jur. 2d,* §139, p. 48. *Scrivener v. Dietz,* 68 Cal. 1, 8, p. 609.

Hence, the requirement of The Bankruptcy Act, that no subsequent lien upon such property could become superior to the transferee's rights under State law, is satisfied.

Here, there is no dispute of the fact that the Attachment was perfected eleven months before the filing of the Petition In Bankruptcy, and hence, the lien of Appellant, A. & E., is clearly beyond the reach of the Trustee in Bankruptcy.

F. Rialto Publishing Co. v. Bass Is Distinguishable From the Present Case.

The Trustee, however, relies heavily upon the case of *Rialto Publishing Co. v. Bass,* 325 F. 2d 527 (9 Cir. 1963). In the *Rialto* case, the creditors levied Attachment June 22, 1961, and *within four months,* on September 15, 1961, an Involuntary Petition In Bankruptcy was filed. *All of the said facts occurred within the four months prior to bankruptcy.* The facts also indicated that June 22, 1961, the creditors had no reasonable cause to believe the bankrupt was insolvent, but that in July of 1961, when the Judgments were reduced to cash, the creditors did have reasonable cause to believe that the bankrupt was insolvent.

The Court of Appeals for the Ninth Circuit upheld the action of the Referee and Trial Judge in holding

that the transfers were voidable preferences, on the ground that the California Attachment was a "contingent lien" citing *Puissegur v. Yarbrough,* 29 Cal. 2d 409, followed in two tax cases, *Ward v. Commissioner of Internal Revenue,* 224 F. 2d 547 (9 Cir., 1955) (holding that $17,000.00 of purchase price of a business was taxable to Ward in 1946 though an Attachment prevented his obtaining the cash until 1947), and *United States v. Security Trust & Savings Bank,* 340 U.S. 47 (holding that a tax lien of the United States was prior in right to an Attachment lien where the federal tax lien was recorded subsequent to the date of the California Attachment but prior to the date the attaching creditor obtained judgment).

The entire series of decisions are hinged upon the *Puissegur v. Yarbrough* decision, in which the California Supreme Court simply held that a party served with a Writ of Attachment should not have paid the money over to the attaching creditor, but should have paid the moneys to the Sheriff, and that consequently, the debt was still unpaid, since the attaching creditor obtained only a "potential right or a contingent lien" as a result of the Attachment. None of the cases hereinabove cited can have any controlling significance in construing the specific provisions of The Bankruptcy Act hereinabove referred to since none pertained to bankruptcy cases.

It is submitted that the *Rialto* case is limited to factual situations wherein the Attachment is levied within four months of the bankruptcy filing and can have no application whatsoever to this case where over eleven months expired between the Attachment and the bankruptcy. Otherwise, the *Rialto* case would be at variance with *Metcalf v. Barker.*

To hold otherwise would be to make the provisions of §§60 and 67 of *The Bankruptcy Act* (11 *U.S.C.A.* §§96 and 107), which allows the annulment of Attachments created within four months of bankruptcy, meaningless.

V.

Conclusion and Prayer.

Various State liens and encumbrances are "inchoate" or "contingent", such as Landlord's Liens, Mechanic's Liens, Pledges and Attachments. The Bankruptcy Act specifically recognizes and allows such encumbrances created four months prior to bankruptcy to stand unimpaired. The *Rialto* case dealt solely with facts occurring within the four month period prior to the filing of the Petition In Bankruptcy, and consequently, does not extend to Attachments outside the four month period. If the four month rule is to be changed it should be done by congressional action, not by this honorable Court.

Wherefore, Appellant respectfully prays as follows:

(1) That the Order of the U. S. District Court affirming the Order of the Referee be reversed.

(2) That the Restraining Order be dissolved.

(3) That Appellant should be awarded its costs, together with such other relief as is appropriate.

Respectfully submitted,

MEYER BERKOWITZ,
Attorney for Appellant,
A. & E. Plastik Pak Co., Inc.

Certificate.

I certify that in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing Brief is in full compliance with those Rules.

MEYER BERKOWITZ